IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 34

FEDERAL POWER COMMISSION, CITY OF AKRON, and PENNSYLVANIA PUBLIC UTILITY COMMISSION, *Petitioners,*

v.

HOPE NATURAL GAS COMPANY, *Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

AND

No. 35

CITY OF CLEVELAND, *Petitioner,*

v.

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BRIEF OF STATE OF WEST VIRGINIA AS AMICUS CURIAE

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This Brief is filed in the present proceedings on behalf of the State of West Virginia, pursuant to Paragraph Nine of Rule Twenty-seven of the Rules of the United States Supreme Court.

OPINION BELOW

The opinion of the Circuit Court of Appeals on the issues here involved is officially reported in 134 F. (2d) 287; and has been included in the Record at R. IV, 169-207.

JURISDICTION

The judgement of the Circuit Court of Appeals, with which the State of West Virginia is in general agreement, was entered on February 16, 1943, (R. IV, 207).

The petitions for writs of certiorari were granted by this Court on May 17, 1943, (___ U. S. ___, 63 S. Ct. 116[illegible], 87 L. Ed. 995, (1943); R. IV, 210).

The jurisdiction of this Court in these causes has been invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, (28 U. S. C., Sections 346 and 347), and under Section 19 (b) of the Natural Gas Act of 1938, (52 Stat. 831; 15 U. S. C., Section 717r [b]).

STATUTES INVOLVED

The Natural Gas Act of 1938 (52 Stat. 821; 15 U. S. C., Sections 717 *et seq.*), which became effective on June 21, 1938, is here involved. Prior to that date, there was no statutory background whatsoever.

West Virginia Tax Statutes, (Code of West Virginia, Chap. 11, Articles 6 and 13), are also involved.

CONSTITUTIONAL PROVISIONS INVOLVED

The Fifth and Tenth Amendments to the Constitution of the United States are likewise involved in this litigation.

QUESTIONS PRESENTED

1. Whether, for rate-making purposes under the Natural Gas Act, the Commission may wholly disregard the ultimate effect upon the economy and well-being of the State of West Virginia, and upon the citizens of West Virginia, of the valuations placed on gas-utility properties.

2. Whether, in the valuation of gas fields and gas horizons, the Commission may deliberately assign over to out-of-state domestic and industrial consumers the entire "advantage of the discovery value" of productive acreage in West Virginia.

3. Whether, for such rate-making purposes, the Commission may completely ignore the legal interest of the lessors of gas-producing leaseholds, in attempting to arrive at a value for West Virginia gas resources.

4. Whether, in drastic reduction of utility values, the Commission may utterly fail to take into account the paramount need for conservation of West Virginia's diminishing gas supply; and may thus fix minimum valuations which discourage exploratory search for new gas deposits, while hastening the abandonment of high-cost, low-yield marginal wells.

5. Whether, by inclusion in the utility rate-base of all by-product operations of an affiliate company, the Commission may accordingly control, in one way or another, investigatory development and research.

6. Whether the Natural Gas Act requires that rates and charges for and in connection with the transportation or sale of natural gas in interstate commerce must be just and reasonable to the state of production, (i. e., in this instance West Virginia),—and to the owners of gas and gas-producing lands in that state,—as well as to the consumers of gas.

7. Whether the rates and charges so ordered by the Commission in these proceedings are just and reasonable to the State of West Virginia, and to its citizens who own gas and gas-producing lands.

8. Whether the Commission's valuation of the properties of Hope Natural Gas Company did disregard the

economy and well-being of the state of production, assign to out-of-state consumers the entire "discovery value," did ignore the legal interests of lessors of gas-producing leaseholds and did discourage exploration and research, and was therefore arbitrary and capricious; and whether the ordered rates and charges were thereby rendered unjust and unreasonable.

9. Whether, under the guise of interstate rate-making, the Commission may, in fact, regulate "the production or gathering of natural gas," despite the explicit statutory provision to the contrary.

10. Whether, by the terms of the Natural Gas Act, the Commission is to value West Virginia's gas reserves as of June 21, 1938, (when the interstate gas traffic was first made subject to federal regulation), or whether the Commission may instead examine into the accounting practices of decades ago, (during which the operating company was a private industry), and thereby retroactively hold the company to have been a public utility even prior to 1938, and retrospectively value its properties.

STATEMENT OF THE CASE

This proceeding was instituted on July 6, 1938, only fifteen days after the effective date of the Natural Gas Act. The original complaint was filed with the Federal Power Commission by the City of Cleveland, Ohio. It complained of the wholesale rates charged by Hope Natural Gas Company on natural gas sold to East Ohio Gas Company, the distributing company serving Cleveland and other Ohio cities. Subsequently, other parties were permitted to intervene.

By its opinion and order, the Federal Power Commission determined that the gross proceeds derived by Hope Natural Gas Company from the production, handling and sale of natural gas in future years, should be reduced by

the sum of approximately $3,600,000. *per* year. Hope Natural Gas Company thereupon filed its petition for review with the United States Circuit Court of Appeals for the Fourth Circuit, and that Court reversed the order of the Commission. The proceeding has now been brought to this Court upon petitions for writs of certiorari filed by the Federal Power Commission, by the cities of Cleveland and Akron, Ohio, and by the Pennsylvania Public Utility Commission.

The tax revenues of the State of West Virginia, and of many of its counties and municipalities, are derived in part from levies imposed upon the true and actual value of properties of natural gas companies, including gas lands, gas leaseholds and gas wells. All of the gas-producing and transporting properties operated by Hope are located in West Virginia. The West Virginia Board of Public Works has fixed the "true and actual value" of Hope's properties, *for West Virginia property-tax purposes*, at $53,338,000. (Ex. 108, Supp. pp. 391-393; and R. 5431-5433). In contrast, the Federal Power Commission has sought herein to establish an interstate rate-base of $33,712,000. *for interstate rate-making purposes.* Should the latter method of valuation be finally sanctioned, there would immediately be a great and irreparable loss of revenue to the State of West Virginia, with serious injury consequent to the school system and other governmental functions. West Virginia also derives a part of its revenues from a tax levied upon the privilege of engaging in the business of producing natural gas, and measured by the gross proceeds derived from the sale thereof by the producer; and the reduction in gross proceeds ordered by the Commission would likewise cause a severe loss of revenue.

The State of West Virginia (as well as the Public Service Commission of West Virginia), intervened in the

consolidated proceedings before the Federal Power Commission. Briefs were filed, and oral arguments made to the Commission. Neither the Commission's order nor its opinion took any cognizance whatsoever of the position of the State of West Virginia; nor did the Commission anywhere refer to the injurious effect upon the fundamental economy of the State of such far-reaching gas-rate reductions.

From the outset, West Virginia has taken the stand that, in fitting the Natural Gas Act into the federal scheme, the Federal Power Commission must arrive at rates and charges which are just to the state in which natural gas is produced, as well as to distant consumers of the gas. Either the Commission must find formulas for the law's application which result in justice being done within the framework of the Act, or states of production may perhaps find ways outside of the Act to escape its more serious injuries. Neither the federal nor the state authorities can desire that eventuality to occur. It will be the purpose of this Brief to demonstrate that the administrative result achieved in the Hope case brings consequences which are unjust to West Virginia and its citizens; and these unfairly depress the value of gas, gas lands and gas leaseholds, unduly restrict development of their natural resources, and arbitrarily transfer their properties to the residents of other states without just compensation therefor.

When the proceeding was taken to the Circuit Court of Appeals by the appropriate review procedure, West Virginia deemed it inadvisable then to continue actively as an intervening party in the various cases, lest its interest in the broader phases of the issue be misinterpreted. The Federal Power Commission had throughout insisted on viewing these proceedings as an ordinary contest primarily between a single producer of natural gas and its

interstate customers; and had seemed unwilling to regard the contentions of the State as having any sort of independent significance. Under such circumstances the State of West Virginia did not participate further in the hearings before the Circuit Court of Appeals. Decision was made, however, to appear as Amicus Curiae in any future argument of the cause before the Supreme Court of the United States, in order that full presentation of the important questions involved in interstate valuation of natural resources might thus be had.

The present Brief as Amicus Curiae is now accordingly filed before this Court.

SUMMARY OF ARGUMENT

West Virginia contends that in determining both the rate-base and the rate, the Federal Power Commission has steadfastly refused to give any consideration whatsoever to the economic welfare of the State of West Virginia and of its citizens; and the Commission's decision would now operate to transfer a considerable part of the mineral wealth of West Virginia over to citizens of Ohio and Pennsylvania. The Commission seeks thus to deprive West Virginia and its citizens of their property without due process of law or just compensation, and to invade unconstitutionally the reserved powers of the State.

I

A. The State of West Virginia, as Amicus Curiae, urges the importance of a fair valuation of its natural gas resources in the economy and well-being of the State. First and foremost, the State has a direct sovereign interest in governmental revenues from its natural gas industry, for without such tax income the essential services of the State must inevitably suffer. The Court has re-

cently recognized the significance of such a public interest by its decision in *Burford* v. *Sun Oil Co.*, --- U. S. ---, 63 S. Ct. 1098, 1100, 87 L. Ed. 999, 1001-1002 (1943). And similarly, in this governmental capacity, the paramount need for conservation must be brought to the attention of the Court.

B. Again, the State may now intervene, in behalf of its citizens, to insure an orderly marketing of its natural resources so as to promote their prosperity and welfare. Since the operating company seldom, if ever, owns the gas reserves in fee simple, it is also proper for the State to propose that the interests of the *lessor*, as well as those of the *lessee*, ought to be fairly appraised in the determination of the interstate rate-base.

C. Finally, to the extent that the State is itself a proprietor of gas fields, it should here protest against any administrative action which might, in the long run, impair the worth of that ownership. Otherwise, its mineral wealth could later be seriously depreciated in value through the policies of the Federal Power Commission; and any contention that the methods of valuation employed were confiscatory would then come too late.

II

West Virginia also contends that the Federal Power Commission has exceeded its jurisdiction under the Natural Gas Act, and has actually applied the provisions of the Act to production or gathering properties, despite the explicit statutory provision to the contrary contained in Section 1(b) of the Act.

III

Under the formulas devised and applied by the Federal Power Commission in this case, the value of the remaining mineral resources of West Virginia will be controlled

by the accidental cost of the mere facilities required to produce them, without regard to their worth either as a fuel or as raw material for commercial products. The manner in which the Commission has construed and applied the Act fails thus to accord with that proper adjustment of local and national interests required by the federal Constitution, and by the federal system.

BACKGROUND OF WEST VIRGINIA'S INTERVENTION

It has become necessary for the State of West Virginia to explain here the legal and factual background of its intervention in these proceedings. While the important facts now adduced are amply set forth in the Record, there is no mention of the State's situation either in the Federal Power Commission's opinion or in any of the various briefs of Commission counsel.

A. The Position of the State of West Virginia.

"In no other field of public service regulation is the controlling body confronted with factors so baffling as in the natural gas industry", (*Pennsylvania* v. *West Virginia*, 262 U. S. 553, 621 (1923), *per* Brandeis, J., dissenting). The present litigation splendidly illustrates that dictum, at least to the extent that future exploitation of West Virginia's gas reserves depends upon their reasonable valuation in interstate markets. In fact, the ultimate issue here goes back twenty years or more, for the whole problem before this Court is simply the orderly development of these mineral resources in accordance with the needs of West Virginia. *Pennsylvania* v. *West Virginia* decided only that a producing state could not, by legislation, require preference to be accorded local consumers, and thereby withdraw a larger volume of gas from an established interstate current. Still the holding did not

in any way involve interstate price-fixing; nor did it go so far as to foreshadow a later attempt to jeopardize the State's economy by harsh undervaluation of operated leaseholds. The question now arises as to whether,—granted West Virginia's gas resources have thus been irrevocably dedicated to intertate commerce,—it is a fair implication from the *Pennsylvania* v. *West Virginia* theory that the producing state should have no voice whatsoever in their management.

The State of West Virginia does not attempt, in the present Brief as Amicus Curiae, merely to advocate the interests of a single producing company. It assumes, rather, that the litigation now before this Court will be determinative of the validity of the current administrative practices of the Federal Power Commission. Thereafter, the same measuring-rod, the same yardstick of valuation, can be applied to other gas operators in West Virginia; and the vital issues will have already been settled. In other words, the State of West Virginia appears here because the precedent which the *Hope* case will establish may become of grave import for the future. Exactly the same issues, the same argument, the same dangers will be met in numerous other proceedings involving West Virginia. In all of them there will be the identical questions,—namely, the position of the producing state in our federal system, and the valuation of mineral resources within the rule of *Pennsylvania* v. *West Virginia*.

This Court will note that the ultimate issue has to some extent been viewed in briefs of counsel for the respective petitioners,—and, indeed, by the opinion of the Commission itself,—as though it were a contest merely between the Standard Oil Company (New Jersey) and the householders of northeastern Ohio and western Pennsylvania. There is the suggestion that the case involves "dividends to Standard Oil"; and the past financial history of the

Standard Oil subsidiary, prior to the Natural Gas Act of 1938, is accordingly scrutinized. To such contentions the State of West Virginia has no reply to make. Whether or not the Standard Oil Company should be regarded as subject to the Public Utility Holding Company Act of 1935,—and analogous questions, are not before the Court in the present litigation. The State of West Virginia is concerned only with the fair valuation of its mineral resources, within the vast scope of the interstate commerce clause. Hence, the circumstance that one of the various operating companies, engaged in "the production or gathering of natural gas," is owned or controlled by Standard Oil is not only irrelevant here, but wholly immaterial. The State of West Virginia regrets that it has been necessary to advert to such allusions in briefs of counsel.

B. Nature of the West Virginia Gas Industry.

Something like half of the nation's total annual consumption of natural gas is presently transported in interstate commerce; and the problem of rate-making becomes a most important one, especially because such an interstate gas traffic (for the most part) denoted purely private business and not public-utility service prior to the 1938 federal law. The Brief for Petitioners, Federal Power Commission *et al.*, (page 78, footnote 37), apparently does not realize that the Hope Company was in no sense a common-law or statutory utility before 1938, (*Missouri* v. *Kansas Gas Co.*, 265 U. S. 298 (1924); *Public Utilities Comm.* v. *Landon*, 249 U. S. 236 [1919]). It also complicates matters that almost four-fifths of the whole national production goes for industrial purposes, with ordinary domestic uses playing a surprisingly minor role in its utilization (Brown, Ex. 19, 6). In other words, unlike the product of most public-service companies, there is actually an existing price for gas which is relatively independent of the customary sales to utility-patrons; and

that gas price had been established (prior to 1938) by trading at arm's length in competition with coal, coke, oil and other fuels.

Moreover, the Court will judicially note that natural gas companies furnish an irreplaceable commodity; a state's natural resources are seriously depleted in this kind of commerce. It is customary to compare the interstate development of gas deposits with the movement of timber, iron ore and other raw materials from mining states to manufacturing centers, (as in *Pennsylvania* v. *West Virginia*); but the essential present factor of price-control, under the Natural Gas Act, is then overlooked. Under normal conditions, there is no restraint on the interstate bargaining as to timber or solid minerals; a producing state's economy is not seriously threatened by outside rate-making. Indeed, the Guffey Act carefully took into account all these factors, so that ideals of conservation and investment-stability were linked up to the concept of consumer protection in bituminous coal price-fixing, (15 U. S. C., Sections 828 to 851). In the absence of such safeguards, interstate rate-making could, in the long run, entail the export of valuable natural resources at a sale-price less than the actual worth of the commodity at the point of origin. And *Pennsylvania* v. *West Virginia* might then lead, under statutory and administrative regulation, to ruthless exhaustion of local gas resources simply for the benefit of nearby industrial states,—a result unthinkable in our federal system.

In West Virginia, the gas-producing sands are continuously variable in thickness; and they are inclined to be lenticular in character, (—which is to say, shaped like a double-convex lens),—with porosity differences causing irregular areas of production. (Tollefson, Ex. 15.) Local geological prophecy is accordingly far less certain than in regions of the southwest; (Sisler and Tucker.

Natural Gas in West Virginia: contained in GEOLOGY OF NATURAL GAS, published by the American Association of Petroleum Geologists [1935]). There is widespread distribution over gently-sloping geological structures, without the concentrated pools on structural highs one finds in Texas or California fields. Erratic sand conditions naturally increases drilling hazards, though the existence of several producing-horizons somewhat balances the chances. But West Virginia leaseholds generally produce lower open-flow volume; in the present litigation, for example, the exhibits show that the 3300 Hope Company wells average only a relatively-small daily yield. Thus the delivery over longer periods of time sends up the overhead charges. The important geological factor in all this is that these gas pools are extremely limited in extent, and separated considerably by unproductive areas; and they occur (along anticlinal structures) on synclines, on the flanks of anticlines and on the crests. It is that very unpredictable quality which, more than anything else, creates so high a discovery value for producing leaseholds. Gas properties then appreciate more and more in value; and the appreciating process continues on indefinitely as the Appalachian fields decline in production. (Stephenson, *Valuation of Natural Gas Properties*, 1015-1016; contained in GEOLOGY OF NATURAL GAS, published by the American Association of Petroleum Geologists [1935]).

This Court has had before it, within the last decade or so, many important cases involving oil and gas production of the southwest, in all of which the issue of conservation of mineral resources was directly or indirectly involved. In no one of the series of these cases,—extending all the way from *Champlin Refining Co. v. Corp. Comm.*, (286 U. S. 210 [1932]), and *Sterling v. Constantin*, (287 U. S. 378 [1932]), down to *Federal Power Comm. v. Natural Gas Pipeline Co.*, (315 U. S. 575 [1943]), and

Burford v. *Sun Oil Co.*, (___ U. S. ___, 63 S. Ct. 1098, 87 L. Ed. 998 [1943]), was the question of acute shortage of mineral resources squarely presented. In contrast, the issue in the past has usually been over-production or waste: for example, *Thompson* v. *Consolidated Gas Utilities Corp.*, (300 U. S. 55 [1937]), revealed that during 1934 and 1935 a billion cubic feet of natural gas was being blown off into the air daily, in the West Texas gas field. (Over a year's time, more gas by far was thereby lost than now remains within the recoverable reserves of the Hope Company's operated acreage). But from these very cases involving such enormous waste, the impression is readily gained that the nation's gas reserves are inexhaustible or nearly so. Now, for the first time, gas litigation is being considered by this Court in which the problem is one of diminishing supply. The fate of the Indiana gas belt, (NATIONAL RESOURCES BOARD, REPORT ON NATIONAL PLANNING, Part IV., *Report of the Planning Committee for Mineral Policy*, 391-439, [1934]), may well prove to be the future in store for West Virginia. In any event, the State has already fallen from first place in national production, two decades ago, to fifth place during recent years. (In 1938, the West Virginia standing was sixth.)

Accordingly, both by reason of geological uncertainties and because of diminishing yield, West Virginia's gas deposits are becoming increasingly valuable. Among the factors to be considered here are the declining volume of output from old wells,—the lower delivering-capacity of new wells,—the increased cost of carrying reserve acreage for future operations,—and the overhead costs of conservation measures. It is impossible to believe that present undervaluation of operated leaseholds can increase the supply of gas available.

C. Method of Gas Leasing in West Virginia.

It might be well to survey briefly methods of gas leasing in West Virginia, in order that various legal incidents of the gas leasehold may readily appear. (Tollefson, Ex. 23; Ex. 26.) Normally the Appalachian oil and gas operator will first select an area for prospecting work, assuming favorable structure and sand conditions; naturally the porosity and permeability of the producing formation cannot be accurately predicted by the geologist until drilling has made considerable data available. And from this angle, new gas supplies must always prove a risky speculation. Granted, however, a promising region has been chosen for prospecting, the process of securing mineral titles then gets under way. Taking into account the cost and uncertainty of buying the mineral rights in fee, the sounder policy of leasing them is ordinarily adopted here, the practice being to get together as large a block of leased acreages as practicable, before drilling a test well in unproven territory. To ensure retaining the benefit of favorable discovery, the operator must therefore acquire and hold thousands of acres during the exploratory period. Otherwise, successful drilling might simply prove territory controlled by others, so that neighboring leases in each direction would have to be bought up in competition with outsiders, and at prices reflecting the operator's own hazardous accomplishment. Yet if a series of dry holes indicates nonproductive land, those very leases will probably be surrendered, and their entire charges be written off as total loss along with the serious drilling expense. By and large, in the gas industry one thus meets with a constant cycle of surrendering old leases and taking up new ones as the effort to locate new reserves continuously persists.

All these areas, both producing and unoperated, are held under oil and gas leases which have usually been se-

cured for a nominal consideration. Under their provisions, the operator pays an annual delay rental—as a rule, a dollar an acre—as compensation for postponing drilling; the so-called fixed term or exploratory period then runs for five or ten years, as the particular lease may provide. If within this term a producing well is successfully brought in, the extension clause ("as long thereafter as oil or gas is produced") next comes into play, and the lease continues indefinitely thereafter for the life of the field. In that event, the operator will pay the lessor a stipulated gas-well rental—ranging between two and three hundred dollars a year for each well from which gas is marketed—or, in the newer fields, the lessor will receive a gas royalty equivalent to one-eighth of the gas marketed. As the production gradually diminishes over the years, the operator nurses the old wells along until the rock pressure falls to the average abandonment minimum, and ultimately the operation is given up.

These details are essential to an understanding of the legal significance of the ordinary gas leasehold, which is simply the legal right of the operator to enter on the lessor's premises, to explore for gas, to "sever" the gas from the freehold by reducing it to possession, and to remove it from the premises. In other words, the gas lessee has a common-law *profit a prendre*, (of an exclusive nature), conveyed originally for a term of years and then on discovery extended for the life of the field. (Simonton, *The Nature of the Interest of the Grantee under an Oil and Gas Lease*, [1917] 25 W. Va. L. Q. 295.) In West Virginia, for example, the operator's interest is treated as a chattel real, which is to say, a *profit* for years rather than an incorporeal hereditament, subject as such to the lien of an execution and taxable presumably as Class IV personalty. (*State* v. *South Penn Oil Co.*, 42 W. Va. 80, 24 S. E. 688 [1896]; *Drainer* v. *Travis*, 116 W. Va. 390, 180 S. E. 435 [1935]). Analogously, the lessor's rent-receiv-

ing reversion in subsurface minerals has separate legal recognition, being valued for tax purposes at several times the annual gas rental or royalty *per* well, depending on the character of the producing field. In other words, both the grantor and grantee of the *profit* own important property interests; and those possess considerable present taxable value, quite apart from the original consideration for the lease and the development costs ensuing later. Between the parties, together they own the gas. All this would seem to be most elementary knowledge in oil and gas law, were it not for the alarming proposal now seriously offered, that the interstate consumers should "reap the advantage of the discovery value" of Appalachian gas leaseholds. Surely *Pennsylvania* v. *West Virginia* ought not to be carried so far.

A further word might be added, too, as regards the claim of the lessor, whose reversionary interest in the gas might be lost altogether if the small well were ultimately surrendered and plugged. Surely, as owner in fee of the gas, he should be represented in some way during the rate proceedings: it is his gas which is being severed and then transported in interstate commerce. Where his compensation is in the nature of a gas well rental for the producing *and paying* life of the field, that rent-receiving reversion ought to justify recognition in leasehold valuation. *A fortiori*, if the lessor under new leases has stipulated for an "eighth" gas royalty, the export price becomes a matter of even more vital concern to him. It is difficult to infer that the instrument of lease contemplated an eventual valuing of both *profit a prendre* and reversion on the basis of the book cost, comprising the original nominal consideration and the later development expense. In that event, the lessor would no doubt be surprised to find that he had absolutely no legal claim to any part of the "discovery value," under the policy of the Federal Power Commission.

D. "The Rate Payers Reap the Advantage of the Discovery Value."

1. *The Policy of the Federal Power Commission.*

In the last analysis, the fundamental issue in the present litigation,—and the one in which the State of West Virginia has deep concern,—is the proper valuation of the gas *profit a prendre,* both as regards producing areas and the unoperated leaseholds prudently held in reserve for reasonably-anticipated market demand. In the course of the Brief of Commission Counsel at the hearings before the Federal Power Commission, (p. 211), the ordinary practice in the gas industry was summed up in these terms:

> "When undeveloped acreage is proved nonproductive, its cost, the cost of drilling and delay rentals, are worthless. If proved productive, however, it suddenly acquires great intrinsic value as a gas-producing acreage. The inclusion of this enhanced value on productive acreage in the rate base, with the depletion expense computed upon such value and allowed in operating expenses, provides for all losses in connection with exploration and development and provides a fund to obtain additional developed gas acreage to replenish the gas supply."

Nevertheless, for the valuation of West Virginia gas reserves, Commission Counsel has advocated, (pp. 211-212), and the Federal Power Commission has adopted quite a different plan. In the discussion of depletion charges, the following rule was proposed by Commission Counsel, (and ultimately approved by the Commission):

> "When gas producing acreage is priced at original cost, there is no enhancement of the depletion expense allowance to cover the costs of explora-

tion and development. The rate payers, therefore, reap the advantage of the discovery value. * * * (Counsel) has recommended that the original cost of producing leases be included in the rate base, in contradistinction from the 'market value' of producing leases."

In view of the confusing terminology of Commission Counsel, a word of explanation might be added here. The term "rate payer" has definite significance both in dictionary-meaning and in legislative use: it is the specific term commonly-employed in England to denote taxpayer.[1] A rate payer is thus one who pays the local (tax) rates. So far as the present case goes, the consumers of northeastern Ohio and western Pennsylvania are in no sense West Virginia rate payers (or taxpayers). The great consumer-industries in these adjoining states contribute absolutely nothing, by way of direct taxation, to the support of West Virginia schools and other essential governmental services. Accordingly, the correct legal statement of the decision of the Federal Power Commission is simply that the (West Virginia) rate payers *lose* "the advantage of the discovery value" (of West Virginia gas reserves). To put it briefly, the out-of-state users gain, while local taxpayers are deprived of the benefit of the fair value of these wasting assets.

In other words, if the operated territory proves productive, the operator is then allowed in his rate-base merely the nominal cost of original acquisition of those acres under which the gas was later found by testing, along with the actual expense of drilling the wells. There is no *discovery-value* for either lessor or lessee: apparent-the gas at once belongs to the interstate customer, sub-

[1]Yet Commission Counsel continuously becloud the issue by its improper use. For example, the Brief of Petitioners, (page 18), argues that "well-drilling expenditures had been contemporaneously recovered through revenues from the rate payers."

ject only to the payment of transportation charges and a reasonable return on the diminutive rate-base of nominal costs and drilling expense. No doubt it might be seriously contended that the operator is amply safeguarded against financial loss by including within the category of operating expenses (1) delay rentals on undeveloped leaseholds, (2) dry-hole losses, (3) disbursements for nonproductive acreage that is abandoned and (4) the other exploration costs. Thus, one can say, the utility has obtained a fair return on the actual-cost basis. As regards the gas properties themselves, the same argument would assume that the consumers have in the past bought a substantial equity in these particular holdings, simply by paying prices that included delay rentals and drilling costs. The fundamental fallacy in it all is the complete failure to consider the reversionary interest of the lessor or the economy of the producing state, not to mention the arbitrary and retroactive policy of viewing the *profit a prendre* on the basis of an investment of decades before, rather than according to its fair value in 1938. And until this Court has ruled otherwise, the State of West Virginia will contend that its natural gas resources as of the year 1938, (theretofore owned by private interstate industry), were being regulated by Congress on today's basis.

2. *Administrative Valuation of Natural Gas Leaseholds.*

So the Commission's order has raised the vital question in this litigation as to how *low* West Virginia leasehold values can be fixed within the limits of the Constitution, in order that interstate domestic and industrial consumers may pay less for the rapidly-diminishing supply of natural fuel. Naturally, it would merely be arguing in a circle to assert that the operator's *profit a prendre* is worth no more than the capitalization of net income from

whatever gas rates may ultimately be established by the Federal Power Commission. The whole difficulty is, what are the proper rates: and the Natural Gas Act specifically empowers the Commission to determine "fair value" in making up the rate-base. One must accordingly start with the valuing of gas properties, before even considering the important collateral issues of operating expenses and rate of return. And any alleged monopolistic character of natural gas, according to Justice Cardozo, may be wholly ignored, (*West Ohio Gas Co.* v. *Public Utilities Comm.*, 294 U. S. 63, 72 [1935]):

> "The suggestion is made that there is no evidence of competition. We take judicial notice of the fact that gas is in competition with other forms of fuel, such as oil or electricity."

If one may properly infer from the very silence of the Natural Gas Act that the method of valuing gas *profits a prendre* is still open, the prior administrative and judicial practice in the task of intrastate rate-making should then be studied. It would be convenient to separate the case-law into two periods, marking the division by the United States Supreme Court's ruling in *United Fuel Gas Co.* v. *Railroad Comm. of Ky.*, (278 U. S. 300 [1929]), a dozen years ago. Originally, in the earlier stage, there was considerable uncertainty among commissions and courts as to how to tackle the issue. Gradually, "present fair value" became the approved test in West Virginia,[2] Pennsylvania,[3] Ohio[4] and New York.[5]

The legal history of leasehold valuation within the Appalachian territory was mirrored in case-law from the

[2] *City of Charleston* v. *Public Service Comm.*, 95 W. Va. 91, 120 S. E. 398 (1923), syl. 2.

[3] *City of Erie* v. *Pennsylvania Gas Co.*, 278 Pa. 512, 528, 123 Atl. 471, P. U. R. 1924D 89 (1924).

[4] *Logan Gas Company* v. *Public Utilities Comm.*, 124 Ohio St. 243, 177 N. E. 587 (1931).

[5] *Pennsylvania Gas Co.* v. *Public Service Comm.*, 207 N. Y. Supp. 599 (1925).

mid-continent field. All the old rulings;—for and against capitalization or for and against present value,—were reviewed in decisions by Oklahoma,[6] Kansas[7] and Montana[8] commissions and courts. The upshot of it all was the approval of an administrative process of valuing gas rights on some basis of present worth, so that the national picture was uniform: up to a dozen years ago, there was very little doubt as to the proper solution.[9]

United Fuel Gas Co. v. Railroad Comm. of Ky., (278 U. S. 300 [1929]), involved valuation of gas rights covering a total of more than eight hundred thousand acres, a relatively small part of which was held in fee. Geological and engineering experts had computed an estimate of the total volume of gas underlying the proven and probable territory. These calculations had been supplemented by testimony that in Pittsburgh there was an unregulated market for industrial gas, which could always be maintained in competition with coal and coal products. Other experts

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[6] *Re Pawhuska Oil & Gas Co.*, P. U. R. 1917D 947 (1917); *American Indian Oil & Gas Co.* v. *Poteau*, 108 Okla. 215, 235 Pac. 906 (1925).

[7] *Landon* v. *Lawrence*, P. U. R. 1916B 331 (1916); *Landon* v. *Public Utilities Comm.*, 242 Fed. 658, P. U. R. 1918A 31 (D. C. Kan. 1917).

[8] *Re Baker Natural Gas Utility*, P. U. R. (1921E 609, 622 1921); *Public Service Comm.* v. *Montana Petroleum Co.*, P. U. R. 1924B 364.

[9] To be sure, the West Virginia Supreme Court of Appeals held, (*Natural Gas Co.* v. *Public Service Comm.*, 95 W. Va. 557, 121 S. E. 716 [1924], syl. 6), that the total of the delay rentals paid had to be taken into account for any survey of appreciation in lease values; yet that judicial result can be understood, even though it seems doubtful. Possibly there was the intuitive thought of achieving lower rates in the regulated West Virginia market for the West Virginia consumers of an exhaustible West Virginia natural resource, as against higher prices in the unregulated sales outside the state. This would seem to be an extremely broad extension of the custom of the lessor's free gas covenant, so as to amount to a "cheap gas covenant" in favor of local consumers; yet in substance that is what the delay-rental holding might accomplish. By keeping down the rate-base through a discount of leasehold appreciation, it is not far-fetched to suggest the West Virginia theory effectively protected domestic consumers. Perhaps it merely illustrated a latent effort to circumvent *Pennsylvania* v. *West Virginia*: granted West Virginia consumers could not have priority as a matter of state legislation, they might at least have more favorable prices for the local product as a matter of judicial decision.

familiar with the production and marketing side had given opinions also based on an assumed gas supply available for unregulated sale at predictable prices. On the other hand, only about a sixth of the entire acreage was proven territory. After characterizing the proof offered as "wanting in probative force," the Court held:

> "On the record as made, appellants have failed to present any convincing evidence of value of their gas field which would enable us to assign to it any greater value than that which they appear to have assigned to it on their books. This book value, therefore, may be accepted, not as evidence of the real value of the gas field, but as an assumed value named by the appellants, which on the evidence presented cannot reasonably be fixed at any higher figure." (278 U. S. 300, 318.)

Accordingly, since the burden of proving the value in a confiscation case rested on the utility, and had to be "supported by clear and convincing evidence," the action of the lower federal court in denying an injunction against the commission rate-making was unanimously affirmed. It must be borne in mind, however, that the company had roughly but seventy thousand operated acres,—with more than ten times that much unoperated,—and it was allowed by the Court to include the latter in its rate-base and their delay rentals in operating expenses. This decision was thus conclusively significant for several reasons. In the first place, the issue as to capitalization was definitely settled, in the affirmative; the value of leasehold had to be taken into account in natural gas regulation. Next, precise evidence was essential in the establishment of the valuation claimed, for the testimony as to a computed value for gas reserves in the ground based on geological estimates and predicted future prices could not be accepted. Nevertheless, the inference was left that had market value, been proven, by adequate sales and purchases

of leases, its adoption would have been approved. Finally, reasonable accumulations of undeveloped acreage might be sustained, where the operator's business required such prudence and foresight.

With the *United Fuel Gas* case, a new chapter began in leasehold valuation. Litigation was henceforth to turn on the adequacy of the proof offered by the operator in support of its position as to present fair value. To be sure, in *Los Angeles Gas & Electric Corp.* v. *Railroad Comm. of Cal.*, (289 U. S. 287, 305 [1933]), the Chief Justice observed as to public utility properties that "the criteria at hand for ascertaining market value, or what is called exchange value, are not commonly available." Still in subsequent rate cases, efforts were diligently made to produce the "clear and convincing evidence" required. *Dayton Power & Light Co.* v. *Public Utilities Comm.*, (292 U. S. 290 [1934]), brought the problem to the Supreme Court once more. In addition to the customary forecasts of production capacity in an unregulated market, there were now instances of actual sales of other leaseholds in sporadic transactions, at disparate prices. The Ohio Commission had actually valued producing acreage at twenty-five dollars an acre, following the precedent of the *Logan* case and disregarding book cost. It was held without dissent that the burden of proof as to confiscation on the basis of the old rates had not been sustained. Recent state cases have tended, moreover, to some sort of present value for gas properties.

The direct issue of leasehold valuation has not again reached the Supreme Court, although the recent decision in the *Natural Gas Pipeline* case is indicative of the Court's interest in the subject. Chief Justice Stone, who wrote the opinion in *United Fuel Gas Co.* v. *Railroad Comm.*, again spoke for the majority; and specifically observed that the Federal Power Commission had here

taken the operator's statement as to the present value of the gas reserves. On the whole, the language of the Court perhaps seems to approve the Commission's action:

> "And the allowed 'present value' of leases as of June 1, 1939, $13,334,775, is approximately $4,000,000 more than book cost, even without taking into account a substantial reduction for depletion services of $1,152,854, which the companies had accrued on their own books by the end of 1938." (62 S. Ct. 736, 744, 86 L. Ed. 699 [1942]).

Nothing was said about undeveloped acreage, nor was there any court reference to the inclusion of delay rentals in some rate-making category.

Sifting down all the case-law for both the periods before and after 1929, certain propositions seem clearly established. In the first place, no court of last resort has refused to capitalized gas leaseholds, although the precise method of capitalization still remains open. Secondly, it has not been held as a matter of federal constitutional law that leases *must* be valued merely at book cost. Thirdly, unoperated territory ought not to be capitalized until there is "present or immediate need" for its use. Fourthly, unusual proof by "clear and convincing evidence" is requisite to support the claim of market valuation. And, finally, delay rentals on reasonable quantities of unoperated leaseholds can be included within operating expenses, (unless the amortization charge be adequate to carry them). It is to be noted, however, that the reversionary interest of the grantor of the gas *profit à prendre*, as well as the economy of the producing state, has scarcely received adequate judicial recognition as yet.

3. *Leasehold Valuation and the Producing State.*

The gravity of the issue before the Court amply justifies this extended discussion of gas-leasehold valuation.

As a matter of West Virginia law, gas reserves are presently valued by the Public Service Commission at their real worth, with certain deductions; if the proposed variant of original cost (adopted by the Federal Power Commission) were to be finally upheld, there would then be two different methods of valuation flourishing simultaneously, side by side. For all intrastate utility service, market value would be the legal standard: but for the interstate gas traffic, something less than out-of-pocket expenditure would control as to leasehold and reversionary interests of producers and farmers alike, in the export of West Virginia's mineral wealth. That result would call up the shadowy ghost of *Swift* v. *Tyson*, (16 Pet. 1 [1842]; see *Note* [1940], *Oil and Gas Law in the Federal Court*, 46 W. Va. L. Quart. 154), to serve as the governing factor in interstate gas-property valuation.

Nevertheless, wholly apart from all these various questions, the paramount consideration now before the Court is the situs of the ownership of the "discovery value," as between the producing state and the distant consumers. An ordinary example will suffice here. Assume there is a block of new operated leaseholds, (with satisfactory rock-pressure), the development of which has cost the operator the following sums:

Nominal consideration	$ 20.00
Delay rentals	1,000.00
Drilling expense:[10]	
30 producing wells at $7,000 per well	210,000.00
Total cost	$211,020.00

In all probability, the minimum present worth of these new leaseholds, with their producing wells, would be (in

[10] Arnold and Kemmitzer, *Petroleum in the United States*, 169 (1931).

normal times) in excess of a half-million dollars. Thus, the "discovery value" of such leases might amount to hundreds of thousands of dollars. The Federal Power Commission has decided that "discovery value" belongs to domestic and industrial users in adjoining states: it is no longer, at least for interstate rate-making purposes, the property of West Virginia and West Virginia operators. To put the issue more succinctly,—West Virginia producers have in the past exported their gas to Ohio and Pennsylvania; and the Commission has now sought analogously to export across the state-line the "discovery value" of West Virginia gas-leaseholds. It is ridiculously absurd to suggest that so important a value ought not to be included within the reckoning of West Virginia's mineral wealth.

Accordingly, the State of West Virginia has been obliged to intervene in these proceedings, simply in order to protect and safeguard its natural resources against arbitrary administrative action. This Court has the serious responsibility of adjusting interstate relations, so as to promote commerce in natural gas among the states in accordance with the mandate of Congress. Still the precedent of *Pennsylvania v. West Virginia* does not compel the surrender of "discovery value" to out-of-state consumers,—nor does the Constitution contemlate so severe an injury to the producing state. Yet the Federal Power Commission has refused even to consider the protests of West Virginia against such spoliation.

ARGUMENT

I

The State of West Virginia, as Amicus Curiae, May Urge the Importance of a Fair Valuation of Its Natural Gas Reserves in the Economy and Well-being of the State.

A. The State Has a Direct Sovereign Interest in Governmental Revenues from its Natural Gas Industry.

This Court has in the past recognized the interest of the State in taxes from its oil and gas industry. In *Burford* v. *Sun Oil Company*, (--- U. S. ---, 63 S. Ct. 1098, 1100, 87 L. Ed. 999, 1001-1002, 1007 [1943], *per* Black, J.), the Court said:

> "Texas interests in this matter are more than that very large one of conserving gas and oil, two of our most important natural resources. It must also weigh the impact of the industry on the whole economy of the state and must consider its revenue, much of which is drawn from taxes on the industry and from mineral lands preserved for the benefit of its education and eleemosynary institutions.[10]"
>
> Footnote: [10] "The problem of gaining an adequate revenue from the petroleum industry was particularly serious in Texas during the period 1930-35. The question was discussed by Governor Sterling in messages to the legislature in 1931, 1932, and 1933, and by Governor Allred in 1935. See The Texas Senate Journal, Jan. 13-May 23, 1931, p. 526; ibid, July-August, 1931, p. 594; ibid, September-October, 1931, p. 164; ibid, August-September, 1932, p. 60; ibid, Reg. Sess. 1933, pp. 587, 589, 590."
>
> Footnote. [26] "The special session of July and August, 1931, was in session when MacMillan v.

Railroad Commission was decided, and, as has been noted above, the MacMillan Case provided the special session with the bulk of its business. People's Petroleum Producers v. Smith (DC) 1 F Supp 361 was the cause of the special session of November, 1932. In his introductory message to the special session, Governor Sterling said: 'Most assuredly, I would not, at this time, have called you into extraordinary session except I believe a grave crisis again confronts the State and our people on account of the Federal Court having held that the Railroad Commission has gone beyond the authority given in this statute enacted at that time in promulgating their orders as to proration and conservation of oil and gas * * * It is apparent that (as a result of the decision) the state's greatest natural resource—oil and gas—will be wasted and destroyed, resulting in a tremendous financial injury to the state, especially to the taxpayers and the public schools. It is apparent that under such conditions, the state's income, as a result of the gross production tax on oil, will be reduced from approximately \$16,000 a day to a few thousand dollars per day, thus depriving the State of a tremendous amount of revenue.' Texas Senate Journal, Nov. 1932, pp. 3, 4."

There is little doubt in the present litigation that the Hope Natural Gas Company will effect a very considerable saving in West Virginia property taxes, as a result of the ordered rate reduction.[11] Certainly, the reduced tax-valuation which unfortunately becomes inevitable, (when the Federal Power Commission fixed the rate-base at roughly \$33,000,000., as compared with the pres-

[11] The Hope Company has represented to the Commission that it expects to save \$338,000 annually, in West Virginia property taxes, (Brief for Petitioners, Federal Power Commission *et al.*, p. 32).

ent Board of Public Works tax-base of almost $53,000,000.), will affect property taxes in most of the counties of the State.[12]

[12] According to the printed Report of the State Tax Commissioner, 1937-1938 and 1939-1940, (pp. 1059 and 1054, respectively), the assessment of the Hope Company by counties is as follows:

	1936	1937	1938	1939
Barbour	$ 261,600	$ 251,800	$ 248,000	$ 251,300
Boone	1,654,800	1,647,200	1,635,800	1,592,900
Braxton	517,900	513,600	531,200	533,700
Brooke	33,300	33,300	33,600	31,600
Calhoun	2,683,700	2,774,500	2,872,700	2,786,500
Clay	121,600	121,400	137,300	97,900
Doddridge	4,316,900	4,376,100	4,398,100	4,174,500
Gilmer	3,433,800	3,561,400	3,570,400	3,382,500
Harrison	11,756,100	11,657,500	11,840,400	11,394,800
Jackson	....	4,300	11,700	11,600
Kanawha	2,665,900	2,742,900	2,832,900	2,820,900
Lewis	4,407,900	4,399,000	4,548,100	4,392,400
Lincoln	65,300	61,100	61,900	60,300
Logan	31,900	34,900	31,400	30,300
Marion	2,950,100	2,907,900	2,875,300	2,818,000
Marshall	$ 1,040,500	$ 1,027,500	$ 1,037,700	$ 1,011,700
Mason	....	200	6,700	6,400
Mingo	20,400	20,800	18,500	17,200
Monongalia	907,300	911,100	906,800	833,200
Nicholas	301,400	282,500	288,400	271,700
Pleasants	307,900	299,500	300,000	282,700
Preston	....	12,400	15,200	15,000
Putnam	....	4,200	4,800	4,500
Raleigh	3,300	3,200	3,300	3,300
Randolph	1,400	1,400	1,400	1,300
Ritchie	3,409,400	3,904,300	3,733,200	3,554,600
Roane	643,700	771,600	811,500	708,400
Taylor	156,200	143,700	166,700	160,600
Tyler	1,551,800	1,605,100	1,619,300	1,547,100
Upshur	43,200	42,500	43,200	47,300
Wayne	900	900	900	300
Wetzel	6,119,300	5,987,800	6,157,400	5,833,500
Wirt	58,300	102,300	104,300	86,600
Wood	1,533,700	1,492,100	1,551,900	1,485,400
Total	$51,000,000	$51,700,000	$52,400,000	$50,350,000

According to Chapter 11, Article 6, Section 11 of the Revised Code of West Virginia, the Board of Public Works has the duty of assessing and fixing the true and actual value of all public-utility property. The West Virginia Supreme Court of Appeals has said that the income producing capacity of property is an inportant factor, (*West Penn Power Co.* v. *Board of Review and Equalization*, 112 W. Va. 442 [1932]). In the face of this statute, and of the Court's interpretation, it would be impossible for the West Virginia Board of Public Works to ignore the effect of an order of the Federal Power Commission which might have the effect of limiting the company's annual net earnings to approximately $2,000,000. If this Court should find that a 6½% return is as low a rate as is fair, it would be very difficult also for the Board of Public Works to contend that the Hope Company's net earnings of $2,000,000 could be capitalized at roughly $53,000,000., present valuation.

The Hope Natural Gas Company is also subject to a business or occupation tax, measured by the value of the gas produced by its operated wells. Under Sections 2a and 3a of this production-tax law (West Virginia Revised Code, Chapter 11, Article 13, Sections 2a and 3a), the levy of the tax is fixed at 7.8% of the gross proceeds from sale of the entire production in the State, regardless of the place of sale or the fact that delivery may be made outside the State. Under Section 1 of the same statute, gross "proceeds of sale" are defined as "the value actually received from the sale of tangible property without any deduction on account of the cost of property sold or expense of any kind." In Section 2, provision is made for determining the value of products transported out of the State; and the tax commissioner of the State is directed to prescribe uniform rules for

ascertaining such value. In measuring value by the gross proceeds derived from their sale, the State has recognized, and has given full effect to the various factors of time, place and conditions influencing the marketing of natural resources. Taxable value thus becomes practically the substantial equivalent of market value.

Exhibit 67, Schedule 8 (Sheets 1, 2 and 3), shows the gross sales and production taxes paid by Hope on both intrastate and export sales during the years 1937, 1938 and 1939. The record does not show what production in m. c. f. for each year was used by the State in determining the value of the gas at well: consequently it is not possible to ascertain the precise m. c. f. value. Nevertheless, production figures for those years appearing in the record indicate that the value, thus ascertained by the State, was *at least 16¢ per m. c. f.* Such official determination of well-mouth value by state authorities is entitled to great weight as evidence. On the other hand, if the value of the Hope properties as estimated by the interstate rate-base is to be reduced by almost two-fifths, then obviously the well-mouth value must similarly be reduced. Granted the unit value of the product is thereby depreciated, the production tax yield must be seriously affected.[12a] Undervaluation of the Hope gas lease-holds must thus cost the State of West Virginia hundreds of thousands of dollars in production taxes.[13]

[12a]Perhaps a minimum estimate of the loss to the State in production taxes might be set forth here. The Federal Power Commission reduced the amount available to the Hope Company for its supply of natural gas by $3,600,000., approximately. Since the tax of 7.8% is based on "the gross proceeds derived from the sale thereof by the producer," (Code of West Virginia, Ch. 11, Art. 13, Sec. 2a), the fall in tax revenue is easily calculated by applying the percentage rate to the reduction in gross income to the Company. The resulting figure of $280,800. represents the immediate cost to West Virginia in production taxes, at the very minimum.

[13]The importance of the production-tax yield to West Virginia can be seen from the following table. (Report of State Tax Commissioner, 1937-1938 and 1939-1940):

The State of West Virginia may now urge before this Court the paramount necessity of the maintenance of its governmental revenues. No arbitrary depreciation of the State's natural resources should be permitted, when the immediate effect of such undervaluation is to cripple the school system and other essential services of the State. The adjustment of the several states within the federal framework of the Constitution surely did not contemplate the impairment of a producing state's tax structure, purely for the benefit of consumers in adjoining industrial states.

The State of West Virginia does not expressly advocate either the prudent-investment or the reproduction-value doctrine in these proceedings; nor does the State urge the approval by this Court of any particular theory of accountancy. The issue is a far graver one. In the adjustment of the several states within the edifice of our federal system, how far may a federal commission regulate the fundamental economy of a producing state?

Note 13—(Cont'd.)

PRODUCTION TAX

Year Ended June 30	*Coal Production*	*Oil and Gas Production*
1935	$2,547,389.95	$1,162,396.11
1936	2,279,903.14	1,270,322.93
1937	2,620,497.51	1,425,529.21
1938	2,454,600.05	1,631,540.58
1939	2,125,021.00	1,344,415.00
1940	2,699,852.00	1,627,145.00

	Clay, Sand, etc. Production	*Timber Production*
1935	$167,867.23	$ 49,050.94
1936	28,153.96	65,923.99
1937	56,299.17	43,914.35
1938	66,764.65	53,167.17
1939		$ 60,362.00
1940		94,333.00

	Other Natural Resources
1940	$ 6,646.00

B. The State Has Likewise a Governmental Interest in the Conservation of Its Natural Resources.

This Court has similarly in the past recognized the interest of the State in the conservation of its natural resources. In *Railroad Commission* v. *Rowan & Nichols Oil Co.*, (310 U. S. 573, 582 [1940], *per* Frankfurter, J.), the Court said:

> "If these wells, most of them small, were restricted to production on the basis of an hourly potential formula, it might be unprofitable to operate them at all. Not only are the individual interests of these small operators involved, but *their effect upon the state's economy is an appropriate factor to be taken into account when plans are devised to keep the wells open.*" (Italics ours.)

That dictum simply reflected the long-continued interest of the Court in matters of state conservation. Starting with *Ohio Oil Company* v. *Indiana*, (177 U. S. 190 [1900]), and continuing on down through *Champlin Refining Co.* v. *Corp. Comm.*, (286 U. S. 210 [1932]), to *Patterson* v. *Stanolind Oil and Gas Co.*, (305 U. S. 376 [1939]), the decisions have consistently favored reasonable statutory and administrative conservation efforts.

The State may now, therefore, represent to this Court how seriously conservation policies will be jeopardized through the present endeavors of the Federal Power Commission to reduce West Virginia leasehold values to a modified "original cost" basis. In three respects at least, the State will suffer:

1. Exploratory development of new fields will be discouraged. Unless the operator profits by the "discovery value" of his new producing lease-

holds, there will be little inducement to undertake "wildcatting" in unproved territory. After all, one well in every five drilled in West Virginia turns out to be a "dry hole";[14] and allocation of the cost of "dry holes" is one of the very issues in the present litigation. With West Virginia's known gas reserves fast diminishing, it is imperative that "wildcat" operations be maintained and encouraged, without penalizing successful development by immediate transfer of its "discovery value" to out-of-state domestic and industrial users.

2. Abandonment of low-yield high-cost marginal wells will be hastened.[15] In the main, the same overhead charges will continue as to smaller producers, regardless of the leasehold valuation. If the leases be undervalued, the net revenue from these older operations will scarcely justify their upkeep. By and large, such wells will then be surrendered far sooner than under existing operating practice. And once a well has been given up and plugged, underlying gas reserves may be lost forever.

3. Secondary recovery of oil,[16] now being undertaken extensively throughout the Appalachian field, will be seriously hampered by arbitrary de-

[14]Tucker, *Future Oil & Gas Supply in Eastern United States*, AMERICAN PETROLEUM INSTITUTE, Minutes of Pittsburgh Meeting, (1943).

[15]As a practical operating decision, Hope abandons wells when the rock pressure reaches 30# in all sands, except the Speechley and the Benson; and 100# in the latter sands. (Exhibit No. 15, p. 15 and R. p. 1053). This decision necessarily depends, in part at least, upon the price received for gas. If that price is reduced, the abandoning pressure will be raised, whereby the rate of well abandonment will be increased.

[16]*Secondary Recovery of Oil in the United States*, AMERICAN PETROLEUM INSTITUTE (1942); *Note* (1942), 49 W. Va. L. Quart. p. 66.

valuation of oil and gas leaseholds. If fugacious minerals are to be undervalued, there is no longer the same incentive to go on with exploratory research in secondary-recovery methods.

Quite apart from these factors, all conservation measures cost money; and when more and more of these measures are utilized, as the gas fields become older, the cost of gas is increased. Decreased leasehold valuation tends to keep such efforts at a minimum; for, after all, the "discovery value" belongs to others. The State has a direct governmental interest in averting such inevitable injury to its natural resources.[17]

C. THE STATE MAY INTERVENE TO PROTECT THE INTERESTS OF ITS CITIZENS UNDER THE PARENS PATRIAE DOCTRINE, AND BY VIRTUE OF THE NATURAL GAS ACT.

It has been held many times by this Court that, in matters of grave public concern, the State, as representative of its public, has an interest apart from that of the individuals affected. Accordingly, as *perens patriae*, the State may sue to vindicate that public interest, and may uphold the rights of its citizens as against out-of-state wrongdoers. (See, *Missouri* v. *Illinois*, 180 U. S. 208, 241 [1901]; *Kansas* v. *Colorado*, 185 U. S. 125, 142 [1902]; *Georgia* v. *Tennessee Copper Co.*, 206 U. S. 230 [1907]; *New York* v. *New Jersey*, 256 U. S. 296 [1921]; *Wyoming* v. *Colorado*, 259 U. S. 419, 464 [1922]; *Pennsylvania* v. *West Virginia*, 262 U. S. 553 [1923]; *North Dakota* v.

[17] The Federal Power Commission apparently believes the conservation problem is not a serious one. For example, the *Brief for Petitioners*, (p. 76), refers to the change of accounting methods in this language:

> "* * * This change in accounting also recognized the progress then being made in gas and oil exploration and in drilling methods, which was bringing about the discovery of huge resources formerly unknown and unavailable and thus was removing the fear of rapid decrease in supply—the raison d'etre of the former accounting procedure."

Minnesota, 263 U. S. 365, 374 [1923]; *Wisconsin* v. *Illinois*, 278 U. S. 367, 409 [1929]; *Kentucky* v. *Indiana*, 281 U. S. 163 [1930]).

There is language in the opinion of *Massachusetts* v. *Mellon*, (262 U. S. 447 [1923]), which might cast doubt upon this general proposition. Holding that a state could not enjoin enforcement of an appropriation act of Congress, Justice Sutherland remarked that a state might not, as *parens patriae*, "institute judicial proceedings to protect citizens of the United States from the operation of the statutes thereof." While no going so far as to say that a state could *never* intervene by suit to protect its citizens against any form of enforcement of unconstitutional acts of Congress, the Court was clear that the right on the part of the state to protest did not arise in the instance of this federal appropriation act. (See, also, *Florida* v. *Mellon*, 273 U. S. 12 [1927]). On the other hand, *Hopkins Federal Savings & Loan Association* v. *Cleary*, 296 U. S. 315 (1935), limited the scope of the *Massachusetts* v. *Mellon* decision. In the course of his opinion, Justice Cardozo said (at page 340):

> "In its capacity of quasi-sovereign, the state repulses an assault upon the quasi-public institutions that are the product and embodiment of its statutes and its policy. Finding them about to deviate from the law of their creation, it is met by the excuse that everything done or purposed is permitted by an Act of Congress. The excuse is inadequate unless the power to give absolution for overstepping such restrictions has been surrendered by the state to the Government in Washington."[18] 80 L. Ed. 261.

[18] Justice Cardozo then added,

"The standing of Wisconsin to resist a trespass on its powers is confirmed if we view the subject from another angle of approach. In the creation of corporations of this quasi-public order and in keeping them thereafter within the limits of their

In other words, the mere fact that the proposed transfer of the "discovery value" of West Virginia's gas deposits over to consumers in adjoining industrial states is permitted by an Act of Congress is wholly inadequate as regards the right of the State to protest against such deliberate spoliation. The natural-gas public utilities of the State must not depart from the duty owed to the citizens of West Virginia.

Nevertheless, without regard to the *parens patriae* doctrine, the Natural Gas Act of 1938 specifically recognizes the interest of the state in the regulation of natural gas undertaken by the Federal Power Commission. Over and over again, the provisions of this statute expressly authorize intervention by the state, or by the political subdivision most directly concerned. (See, for example, 15 U. S. C., Sections 717c[e], 717d, 717j, 717l, 717p, and 717r.) Thus, the Act of Congress has itself definitely recognized in this instance the right of the state to participate on behalf of its citizens. The present brief, as *Amicus Curiae*, now sets forth the grave concern of the State of West Virginia, lest irrevocable harm be done its citizens through the Commission's arbitrary undervaluation of the State's natural resources.

1. *The State of West Virginia, in Common with All States Whose Economy Is Based on the Development of Natural Resources, Is Vitally Interested in the Orderly Marketing of Its Mineral Wealth, so that the True Value of These Minerals May Be*

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charters, the state is parens patriae, acting in a spirit of benevolence for the welfare of its citizens. Shareholders and creditors have assumed a relation to the business in the belief that the assets will be protected by all the power of the government against use for other ends than those stated in the charter. Aside from the direct interest of the state in the preservation of agencies established for the common good, there is thus the duty of the parens patriae to keep faith with those who have put their trust in the parental power. * * *"

Returned to the State's Total Resources, as the Wasting Assets Become Exhausted.

The State of West Virginia, as *parens patriae*, is interested in ensuring for its citizens the orderly marketing of its mineral resources. (See *Railroad Commission* v. *Rowan & Nichols Oil Co.*, 310 U. S. 573 [1940]). In short, the State may now intervene on behalf of its people, in order to avert the serious consequence of a grossly unfair undervaluation of its natural gas resources by the Federal Power Commission. This litigation directly concerns one of the great industries of the State; and its importance is such that any harm to the industry must inevitably affect the welfare of a very large group of its citizenry.

Perhaps the effect of the undervaluation of West Virginia's gas deposits might be indicated in terms of the well-mouth gas prices. Exhibit No. 49 represents an analysis of natural gas purchased and prices paid during the three-year period 1937-1939, by the twelve largest utilities operating in West Virginia. The record shows that the price paid for gas varies, according to the county and section of the State; for example, Exhibit 79 (Table V) shows gas purchased by South Penn Natural Gas Company in Boone and Kanawha Counties, in the southern part of the State, was priced at approximately twelve cents per m. c. f. On the other hand, in the central and northern parts of the State, gas was bought by South Penn at prices ranging from seventeen cents to twenty-two cents per m. c. f. In any event, purchases made by other companies, not connected with the Hope System, occurred at an average price of fifteen cents per m. c. f. It is not unreasonable, therefore, to assume that the well-mouth market-value of gas produced in the Hope territory was in the neighborhood of *fifteen cents per m. c. f.*, as of 1938, when the Natural Gas Act became effective.

In contrast to the foregoing, a further analysis has been made to determine *the exact part of the total income* under the rates set by the Federal Power Commission order, which might become available to cover the well-mouth price of the gas produced by the Hope wells, after paying all expenses other than well-expense. (This analysis is printed in Appendix I, to the present Brief). In order to ascertain that well-mouth price, all items of operating revenue and deductions have been carefully segregated (other than those specifically applicable to well-head or well-mouth production). On completion of such analysis and segregation of items, the remaining revenue left to cover the well-mouth price for producing natural gas is set forth by the following summary:

Other Production Expenses (Col. 5)	$ 967,929
Gas Purchased Expense (Col. 7)	7,379,437
Transmission Expense (Col. 8)	4,080,598
Total Expense for other than Gas Produced	$12,686,898
Amount Allowed for Gas Produced	3,258,934
Total of Recommended Gross Revenue per page 54 of Opinion	$15,686,898

Continuing with this summation of well-mouth price-estimates, an analysis of Exhibit 69A shows that the volume of gas produced by the Hope-owned wells in 1940 was, in round figures, about twenty-seven million m. c. f. The allowance of $3,258,898 by the Federal Power Commission for Hope-produced gas, at the well-mouth, is therefore *about twelve cents per m. c. f.* If even as little as one-half of the delay rentals be transferred to general or other expense, the well-mouth allowance is reduced to approximately *ten cents per m. c. f.;* should any adjustment be made for federal income taxes or reclassification

and rate-case expenses, the allowed well-mouth price will be even further reduced. In short, these analyses conclusively establish that the recommended reduction in rates will result in a well-mouth price for Hope-produced gas which is *from three to five cents per m. c. f. less than the going-market price.* Hope gas is to be valued by the Federal Power Commission at ten or twelve cents per m. c. f.: open-market purchases of gas in the Hope territory have occurred at an average price of fifteen cents per m. c. f., hence, were the Federal Power Commission order now to be sustained, Hope would be compelled to sell its product at a price less than the cost of gas in producing regions.

Serious as the Federal Power Commission's order may be in thus reducing gas prices below cost, the City of Cleveland's proposal is even more disastrous for the gas industry. It was contended by counsel for the City of Cleveland, in the reply brief before the Federal Power Commission, that rates should be fixed which would net the Hope Company only 3.64¢ per m. c. f., for some ten million-odd m. c. f. of gas to be consumed. In other words, it is thus the position of the City that gas should be delivered to Ohio consumers *at less than one-fourth of its actual value* in West Virginia. Surely the very nature of this proposal indicates the background of the decision by the Federal Power Commission.[19]

2. *The State of West Virginia Must Be Assured that a Reasonable Price Will Be Fixed for the Interstate Gas Traffic, in Order that the Values of Other Competing Natural Fuels Produced Within the State May Be Properly Safeguarded.*

An equally important consideration here concerns the competition of natural gas in the open market with coal,

[19]The proposal of the City of Cleveland in this regard has been set forth in detail in Appendix II to this Brief.

oil and other fuels. Of course, natural gas does not enjoy a monopoly like electricity or water, for which there are no practicable substitutes. But consumer-demand for gas is substantially voluntary; if the price be too high, consumers can, and do, shift to other forms of fuel. Indeed, such a change from gas to coal was actually recommended by the Commission's engineer, (R. pp. 4439-4444), for the Hastings Compressor Station of the Hope Company. Yet the converse is also true. If natural gas be materially cheapened, consumers will turn to that fuel in preference to coal or oil. In consequence, an arbitrary and unfair undervaluation of natural gas will have the effect in West Virginia, in the long run, of depreciating further the price of West Virginia coal and oil. If there were no other reason to be furnished here, the very circumstance that West Virginia's competing fuel industries would be injured by such confiscatory administrative action as to its natural gas might amply justify the State in intervening on behalf of its citizens. (See, as to the nature of the competition between natural gas and the coal industry, *Brief on Behalf of Legislation Imposing an Excise Tax on Natural Gas*, (1934), submitted to the Division of Economic Research and Planning of NRA, by the National Coal Association and the United Mine Workers of America).

3. *The State of West Virginia May Insist that the Prices Now Fixed for Natural Gas Will Protect and Conserve the Supply of Its Various Constituent Hydrocarbons for Future Demands of the Chemical Industry.*

Finally, there is one further factor to be borne in mind. The exhibits in this case show that West Virginia natural gas is composed of butane, ethane, pentane, propane and many extremely valuable lighter hydrocarbons. For ex-

ample, a very considerable proportion of butane is yielded from these natural gas deposits, which becomes of great importance in the production of butadiene for synthetic rubber purposes. In some respects, indeed, West Virginia gas is unique in its chemical composition, because so many of these relatively scarce hydrocarbons are present. It is not unreasonable to infer from this very situation that an expansion of the chemical industry will produce a vastly-increased demand for the refining of natural gas. Were that eventuality to come about in the face of a diminishing gas supply in West Virginia, it is reasonably possible that the use of natural gas for fuel purposes might be deliberately discouraged. That is to say, West Virginia gas would be far too valuable to be utilized merely for ordinary fuel-consumption purposes. Neither the present leasehold valuations nor the consequent well-mouth prices even take into consideration the existence of so important a factor. (See Price and Headlee, *Geochemistry of Natural Gas in Appalachian Province*, [1924] 26 Bulletin of American Association of Petroleum Geologists 19).[20]

[20] If the principles applied by the Commission in this case are upheld, then West Virginia must abandon all hope of that bright economic future whose dawn is just now disclosed by the rising sun of technological research. What shall it profit West Virginia that silk stockings can be made from gas, that alcohol obtained from gas makes rubber, that American soldiers ride the skies in parachutes made from gas, that in gas are found those hydrocarbons whose atoms can be rearranged by men of science into products as yet unknown to commerce? From all these and the wealth they promise, West Virginia must resolutely turn away, for the wealth the State might otherwise expect must henceforth and forevermore be restricted to a mere non-confiscatory return upon the original cost of the facilities used to produce the gas. Raigorodsky and Dotterweich, *War Products from Natural Gas and Natural Gasoline*, (1943), 14 PETROLEUM ENGINEER, 198, 203: "Constant vigilance on the part of the petroleum industry relative to the great potential possibilities of natural gas and natural gasoline will not only materially aid in the production of war products required by our armed forces but will place this industry in a most advantageous position to convert to the production of the immense quantities of synthetic consumer goods that will most assuredly come with the return to peace."

D. The State May In This Litigation Represent the Interests of West Virginia Lessors of Natural Gas.

In has already been indicated that natural gas is developed in West Virginia through a long-established method of leasing, by which the operator develops the land-owner's gas on a royalty basis. That owner retains his rent-receiving reversion, along with his legal right to cancel the outstanding lease in the event of abandonment or forfeiture; and the lessor's reversion is thus a valuable and well-defined property interest. However, the Federal Power Commission has utterly ignored the existing legal position as regards the West Virginia lessor. In effect, the Commission has insisted upon treating the Hope Company as though this operator were the sole owner in fee simple of all natural gas deposits involved in this litigation.

This Court will take judicial notice of the commonly-recognized fact that West Virginia is not an agricultural state, nor one which is suited for ordinary farming purposes. Its resources are largely those of mineral wealth, so that reasonable development of the State's coal, oil and gas has been the basis of its economy. In this connection, it might be said, ownership of fugacious minerals in fee simple has been for decades a rule of property law in West Virginia, (*Williamson* v. *Jones*, 39 W. Va. 231, 10 S. E. 436, [1894]; *Wilson* v. *Youst*, 43 W. Va. 826, 28 S. E. 781, [1897]; and *Preston* v. *Young*, 57 W. Va. 278, 50 S. E. 236, [1905]). Complete legal protection has always been given to the reversioner's interest, in the judicial treatment of the oil and gas leasehold. Now, for the first time, it is proposed to do away with such a fundamental doctrine of West Virginia

legal theory, and to regard the operator as the sole spokesman for the fee ownership of natural gas.

In two respects, at least, the result is fraught with serious consequences. On the one hand, no attention has been paid to the lessor's rent-receiving reversion; whether this be fixed on a gas-well rental basis or whether a one-eighth gas royalty has been stipulated. The Federal Power Commission may assert that the inclusion of rentals and royalties in operating expenses amply protects the lessor; and perhaps that would be true, were all the lessor's revenues actually contractual gas-well rentals. However, most modern West Virginia leases are now executed on a one-eighth gas-royalty basis, so that the well-mouth price of gas becomes the standard of the reversioner's compensation. It is once more arguing in a circle to assume that operating expenses can determine the amount of the farmer's income from the gas well, when the ultimate question is the precise price of gas,—which is to determine his one-eighth royalty. On the other hand, apart from the gas-well rental and gas royalty issue under the Natural Gas Act, no interstate producer can abandon either facilities or service without the Commission's approval, (15 U. S. C. 717f[b]); so the rule of *Pennsylvania* v. *West Virginia* has now become statutory law. Lessors have accordingly devoted their gas rights to an interstate public use. It would seem that the farmer cannot in the future withdraw his gas from the established current of interstate gas traffic. In short, the gas-owner's reversion has become public-utility property.

Even though a lessor has these vital interests in his rents and in the future of his reversion, the Federal Power Commission is unwilling to recognize that ownership. The State of West Virginia may thus insist that

no regulation of a local gas industry can be complete, unless the rights of the reversioner have been taken into full account. So long as the West Virginia farmer's best crop comes from the gas well on his land, the Commission must take that property interest into consideration in the working out of the State's future economy.

E. The State Has a Proprietary Interest In Leasehold Valuation, as Owner of Gas Deposits Under Public Lands.

According to the Constitution of West Virginia, (Constitution, Article XIII, Section 3), the State is owner of all waste and unappropriated lands. Among such unappropriated land is the bed of the Ohio River, which is held directly as the property of the State of West Virginia; and valuable mineral interests are known to underlie this river-bed. Moreover, the Public Land Corporation of West Virginia,—a governmental corporation,—has now been vested with the title of the State in other public lands, such as forfeited and unredeemed tax-delinquent properties, (West Virginia Revised Code, Chapter 37, Article 2A). Thus, West Virginia must be regarded as owner in fee simple of much land scattered throughout the State.

As land-owner, the State of West Virginia has a direct property interest in the protection of its gas deposits. It may, therefore, insist upon their proper valuation, and upon the orderly marketing of all underlying gas deposits. Unless the State now intervenes to protect its own natural gas, the administrative methods of valuation and marketing may be finally adjudged in the present proceeding. Accordingly, it is submitted that a reasonably fair valuation of leaseholds should be established, so as to create adequate markets in the future for all State-owned gas resources.

II

The Federal Power Commission Has Disregarded the Specific Intent of Congress That the Provisions of the Natural Gas Act Shall Not Apply to Production Properties.

In this case, the Commission has applied the provisions of the Natural Gas Act to the business of producing and gathering natural gas, contrary to the express language of Sec. 1 (b) of the Act, reading:

> "The provisions of this Act * * * shall not apply * * * to the production or gathering of natural gas."

The rate ordered by the Commission is calculated by adding together two principal components, i. e., (1) an allowance for the expense of interstate transportation, plus a return upon properties devoted to transportation, and (2) an allowance for the expense of production, plus a return upon properties devoted to production. The amounts included in the rate base and in expense are separately determined for transportation and for production in the Commission's opinion. In determination of the rate base, Hope's properties are separated into three general classes which are given the following designations by the Commission:

Natural Gas Production Plant
Transmission Plant
General Plant

The Commission's opinion shows that it applied the provisions of the Act to all phases of the natural gas industry, beginning at the bottom of the well and continuing to the end of the transmission system.

The Commission investigated the original cost of drilling each hole and of the casing, tubing and other equip-

ment of each well. The same investigation was made of gathering lines. It likewise investigated the original cost of the leaseholds owned by Hope, and made a determination as between operated and unoperated acreage. From these investigations the Commission ascertained what it finds to be the original cost of the natural gas production plant and the amount of depreciation and depletion accrued therein to date. It also determined that part of the cost of certain of Hope's wells should be deducted from the total because such cost had been charged to operating expenses in previous years. Thus, the cost-finding and accounting provisions of the Act were applied to Hope's production and gathering properties. Having made these determinations, the Commission thereupon proceeded to apply the rate-making provisions of the Act to production and gathering properties. It added the cost of production properties to the cost of transmission properties and used the aggregate cost of all properties as the basic amount from which the rate-base was determined.

During the more than forty years of its existence, Hope has taken leases on more than 4,100,000 acres of land in West Virginia; leases on 3,150,000 acres have been cancelled; constant turnover and shifting of leases are involved, new leases being taken, and leases being cancelled and renewed and cancelled again, as discovereies are made. (Hope Exhibit No. 23, Methods of Gas Exploration and Development in West Virginia). The connection between such activities and the interstate transportation and sale of gas is remote. But their connection with the production of gas is immediate and direct. The Commission further extended the Act to regulation of the amount to be expended for future exploration and development, and of the amount to be included in expense for the cost of abandoning wells. The provisions of the

Act were thus applied to lands, leases, leaseholds and wells and will regulate the value of natural gas, not only at the well mouth before it enters interstate commerce, but while the gas is still in the ground, and the value of gas lands and gas leases. The effect of this regulation upon the resources of the state and counties and the properties of private landowners has been discussed elsewhere in this Brief.

Natural gas as an article of commerce is purchased and sold in an "open market" in which "fair market value" exists. The West Virginia Supreme Court has held that in establishing intrastate rates for natural gas, the utility will be charged with the *fair market value* of gas sold for out-of-state delivery to affiliated companies. (*Charleston v. Public Service Commission*, 95 W. Va. 91 [1923]; points 6 and 8 of official syllabi by Court.) In that case the contract price to the parent companies was less than fair market value. Under the Commission's order in the present case, the price Hope may charge for gas sold to its affiliates is fixed by regulation at less than market value. We concede that a fair return to their common stockholders upon the combined values of Hope's property and the property of its affiliates will satisfy constitutional demands. But the Commission's order, by disregarding the market value of gas, has appropriated to Hope's interstate customers an undue proportion of the total income of all affiliated companies; and in any future intrastate rate regulation by West Virginia, the market value of gas delivered to affiliates can no longer be included in total income, and only the value as fixed by the Commission may be so included. The West Virginia Court will apparently be compelled to change its rate-making principles.

Production of natural gas—the reduction of it to possession by wells bored from the surface—is a local or

state activity, subject to regulation by the state. (*Ohio Oil Co. v. Indiana*, 177 U. S. 190, 44 L. Ed. 729 [1900]). The state's rights to control and regulate oil wells were recently affirmed. (*Champlin Refining Co. v. Corporation Commission*, 286 U. S. 210, 76 L. Ed. 1062 [1932]; *Railroad Commission v. Rowan & Nichols Oil Co.*, 310 U. S. 573, 84 L. Ed. 1368 [1940]).

The local or interstate character of the business of producing gas, as it is conducted by Hope and now subjected by the Commission to the provisions of the Natural Gas Act, was adjudicated by the Supreme Court of West Virginia in (*Suttle, Adm'r. v. Hope Natural Gas Company*, 82 W. Va. 729 [1918]). Erecting a derrick to be used in cleaning one of Hope's gas wells to accelerate its production was the activity involved. West Virginia's Court said:

* * *

> "Hence it becomes necessary to consider whether the work which the deceased was doing was clearly separable and distinguishable from interstate commerce. Until reduced to possession by confinement, natural gas, it is said, though somewhat inaccurately, partakes of the nature of ferae naturae. It is not the subject of ownership till brought to the surface and confined, and of course cannot become the subject of interstate commerce till its ownership becomes complete by confinement in the ordinary, indeed the only competent, mode of transportation, pipe line conduits. The well reaches down to the gas bearing strata and releases the gas there confined, but until it reaches the surface and enters the pipe for transmission to the interstate trunk lines, it is not in interstate commerce. The production department of the gas industry is clearly separable from the transporting or marketing branch. All work in con-

nection with the production of gas, that is, with bringing it to the surface where it may be confined and reduced to possession, is local in nature and clearly separable and distinguishable from the marketing or interstate portion of the industry."

* * *

It will not be presumed that Congress intended to confer any jurisdiction over such local or state activity to the Federal Power Commission, (*Federal Trade Commission* v. *Bunte Brothers*, 312 U. S. 349, 85 L. Ed. 881 [1941]). In (*Kirchbaum* v. *Walling*, 316 U. S. 517 [1942]), this Court said:

"To a considerable extent the task is one of accommodation as between assertions of new federal authority and historic functions of the individual states. The expansion of our industrial economy has inevitably been reflected in the extension of federal authority over economic enterprise and its absorption of authority previously possessed by the States. Federal legislation of this character cannot therefore be construed without regard to the implications of our dual system of government.

"We cannot, therefore, indulge in loose assumption that when Congress adopts a new scheme for federal industrial regulation, it thereby deals with all situations falling within the general mischief which gave rise to the legislation. Such an assumption might be valid where remedy of the mischief is the concern of only a single unitary government. It cannot be accepted where the practicalities of federalism—or, more precisely, the underlying assumptions of our dual form of government and the consequent presuppositions of legislative draftsmanship which are expressive

of our history and habits—cut across what might otherwise be the implied range of the legislation. Congress may choose, as it has chosen frequently in the past, to regulate only part of what it constitutionally can regulate, leaving to the States activities which, if isolated, are only local.

"* * * The history of congressional legislation regulating not only interstate commerce as such but also activities intertwined with it, justifies the generalization that, when the federal government takes over such local radiations in the vast network of our national economic enterprise and thereby radically readjusts the balance of state and national authority, those charged with the duty of legislating are reasonably explicit and do not entrust its attainment to that restrospective expansion of meaning which properly deserves the stigma of judicial legislation. * * *"

It may be argued that authority to so apply the provisions of the Act to the business of producing natural gas may be drawn from other sections of the Act. Section 5 (b), for instance, gives the Commission authority to investigate and determine the cost of the production of natural gas by a natural gas company in cases where it has no authority to establish rates. Section 6 (a) gives the Commission authority to investigate and ascertain the actual legitimate cost of the property of every natural gas company. Section 9 (a) gives the Commission authority to determine rates of depreciation and amortization of production property. Section 10 (a) enables the Commission to require filing of reports including cost of facilities and of maintenance and operation of facilities for production of gas. Section 14 (b) permits the Commission to determine the adequacy or inadequacy of reserves. In only one of these sections did Congress use language implying that the result of any such determina-

tions might be reflected in the establishment of a rate. This provision is contained in Section 14 (b) where the Commission is authorized to determine the propriety and reasonableness of including delay rentals, or other forms of rental or compensation for unoperated lands and leases, in operating expenses, capital or surplus.

To hold that these other sections give the Commission authority to apply its rate making principles to the production of gas, beginning with lands and leases both operated and unoperated and continuing from the bottom of the well to the end of the transmission system, makes the latter sections override Section 1 (b) and completely destroy it. No part of the natural gas industry related to interstate transportation and sale, to which the negative language of Section 1 (b) can apply, would remain.

In acertaining the scope of this legislation and in thus applying the provisions of the Act to production properties and that part of the gas business devoted to production of gas, the Commission had no regard whatsoever for a proper adjustment of local and national interests in our federal scheme. (*Federal Trade Commission* v. *Bunte Brothers*, 312 U. S. 349, 85 L. Ed. 881 [1941]). On the contrary, it wholly ignored the interests local to West Virginia and with an eye single to interests local to Ohio and Pennsylvania, applied the Act to every phase of the gas business and drastically reduced the values of gas and gas producing lands in West Virginia.

The manner in which the Commission has applied the Act to the local activity of producing gas, and its inescapable regulation of local economy, are perilously close to an invasion of the sovereignty or quasi-sovereignty of West Virginia, and of a field of autonomy preserved against federal encroachment by the Tenth Amendment. (*Hopkins Federal Savings & Loan Assn.* v. *Cleary*, 296 U. S. 315, 80 L. Ed. 251 [1935]).

Moreover, Hope Construction & Refining Company operates some natural gas wells and about one thousand (1000) oil wells producing casinghead gas (R. 4252). Its gas from dry gas wells and its casinghead gas from oil wells is sold to Hope and becomes an integral part of the gas from which gasoline and butane are extracted and of the mass of gas delivered to consumers by Hope. The recommended method of handling the income of Hope Construction & Refining Company will be fatal to the gasoline extraction business and to experimental research in West Virginia, or at least to that part of the business conducted by affiliates of the natural gas companies.

III

The Proper Adjustment of Local and National Interests Necessitates Modification of the Federal Power Commission Order.

If we were unable to suggest formulas upon which rates for interstate transportation and sale of gas might be established other than the formula followed by the Commission, considerable force might be lent to the Commission's construction of the Act. However, at least one other way was suggested to the West Virginia Public Service Commission in 1926 by a Federal Court. That was the case of (*United Fuel Gas Company* v. *Public Service Commission*, 14 Fed. [2d] 209, affirmed 278 U. S. 322 [1929]), involving, among others, the vexatious problem of the value to be given natural gas reserves—that and other problems, the Court said, were difficult or impossible to solve. The solution suggested was (1) that the value of the utility's *tangible* property be ascertained with an allowance for working capital and going concern value, which would represent all upon which a return should be earned and depreciation and amortization allowed, and (2) that *the fair market value of gas delivered*

to customers be added to the outlay for operating expenses and taxes in determining whether the rate was sufficient to cover a return and an allowance for depreciation and amortization. That the suggestion was dictum may be admitted, but the decision was by a three-judge statutory court.

In its brief and argument before the Commission, West Virginia urged that there must be separate determination of the value of gas at the well mouth based upon the going market value in the field where the gas is produced; that such amount having been determined the interstate rate might be established by adding thereto the allowance for operating expenses, depreciation, taxes and return on the transportation system. This is consistent with *Hope Natural Gas Company* v. *Hall*, (102 W. Va. 272, affirmed 274 U. S. 284 [1927]), approving ascertainment of the value or worth of gas *in West Virginia* for tax purposes. Of course, we do not mean to imply that these are the only formulas that can be devised for applying the Act with proper adjustment of local and national interests.

Natural gas, as a fuel or as the raw material for commercial products, is marketed in competition with coal and oil. (see *Appalachian Coals, Inc.* v. *U. S.*, 288 U. S. 344, 361-362 [1933]). Its worth for either use is relative and is controlled by comparison of its values with the values contained in coal and oil. The competitive relationship between gas and coal as fuel is dramatically illustrated in this case by the recommendation of the Commission's gas engineer that during periods of peak demand for gas the power requirements of Hope's system be obtained by using coal instead of gas as fuel, (Record, pp. 4439-4444). Nor does all natural gas have the same worth. Its content of methane, ethane and nitro-

gen, and its heating value vary as between fields and as between wells. From the standpoint of the owner of a supply of natural gas, its proximity to markets is an economic advantage over more distant fields. All of these considerations affect value. None of them have been given any consideration by the Commission.

Ascertaining the going-market price of gas at the well mouth is difficult but not impossible. For fifty years business men in West Virginia have done it, and billions of feet of gas have changed hands on their judgments as to its price, thousands of leases have been purchased and sold, well drilling operations have been started or stopped, pipe lines built and capital investments made. Any regulatory commission can make the determination if it will accept the same evidence that ordinary reasonable men accept. The difficulty has been to produce evidence which a regulatory Commission could not constitutionally ignore. The Commission partially investigated it in the present case. Its staff prepared and filed an exhibit entitled "Analysis of Natural Gas Purchased and Prices Paid by Utilities in West Virginia." (Exhibit No. 49.) In this exhibit the staff analyzed all purchases made in West Virginia by the twelve largest utilities during the three years 1937, 1938 and 1939. Tables III, IV and V filed with this exhibit show that such utilities paid thirteen cents or more per m. c. f. for approximately sixty per centum of their gas. The exhibit shows, and we freely concede, that conditions of delivery vary widely and the price named in one purchase contract may not be comparable with the price named in other contracts. But adjustments may be made to correct such variations and the exhibit contains this statement: "The prices presented here are representative of West Virginia natural gas prices because they include more than 90% of such purchases." (Page 2 of Exhibit.)

In the three years covered by this exhibit, the gas purchases by the twelve utilities was roughly seventy per centum of the State's total production.

Ascertainment of the prices paid for the gas not purchased by the twelve utilities, including unregulated sales to industrial plants, presents no insuperable problem. Analysis of all sales, regulated as well as unregulated, with proper adjustments for sales between affiliates that are not arm length sales and other adjustments, would disclose the well mouth market price or market value of West Virginia gas. A rate based thereon would reflect the value of gas as a fuel and as the raw material for products of commerce, and the effects thereon of competition and the myriad factors that make market prices. Of a value thus determined, West Virginia cannot and would not complain.

All of Hope's properties, transportation properties as well as production properties, lie, and all of its business is done, within the borders of West Virginia. Assessment of such properties for taxation in order that they may bear their full share of the burden of State and local government is in consequence a matter of extreme importance to the State. If, through the action of the Federal Power Commission, any property has been eliminated from the assets of the company, assessed values will immediately be affected.

Of course, there could be no physical elimination of any property from assets. Such elimination would be accomplished, however, by a method of rate regulation, which, when principles of assessment for taxation were applied to the result, would necessarily require omission of property from the tax base.

Properties of natural gas companies in West Virginia are assessed by the Board of Public Works at their true

and actual value, (*Code of West Virginia*, Chap. 11, Art. 6, Sec. 11). Value is an economic fact. For public utilities it is to some extent a result of rates; and the amount of value which will result from a given rate base can in part be estimated. (*Dorety, The Function of Reproduction Cost*, 37 Harvard Law Review, 173 at 189.) The principles governing the ascertainment of value for the purpose of taxation are the same as those that control in condemnation cases, confiscation cases, and generally in controversies involving the ascertainment of just compensation. (See *Great Northern Railway Company* v. *Weeks*, 297 U. S. 135, 80 Law. Ed. 532 [1935]).

When West Virginia comes to apply the principles which govern the ascertainment of the value of Hope's property for taxation, it cannot ignore the impact upon earnings resulting from the Commission's regulation of Hope's rates. If any property has been omitted from the rate base so that no earnings can accrue thereon, West Virginia cannot continue to retain the value of such property in the tax base. This is not required by any provisions of constitutions or statutes. It is rather because reason and experience have taught that sterile property, property which has lost the power to produce profit, ultimately becomes worthless in the commercial world, and things which become worthless in the commercial world sooner or later cease to be the subjects of taxation. Furthermore, the omission of this item of property from the rate base necessarily reduces the gross proceeds derived from the sale of gas upon which West Virginia levies a tax for the privilege of engaging in the business of producing gas, (*Code of West Virginia*, Chap. 11, Art. 13).

Going concern value was wholly omitted from the rate base on which the commission permitted Hope to earn a return. The rate base is frankly and openly restricted

to actual depreciated cost. Going concern value need not be separately stated if it is otherwise included in the rate base, but when original cost alone is used, it cannot be claimed that going concern value was included.

To a considerable extent, the Commission determined Hope's rate of return upon considerations indicating recognition of elements of going concern value. The company's efficient management, it said, and its established markets, its available supply of gas, its financial record, its affiliations and prospective business placed it in a strong position to attract capital upon favorable terms when it is required. Hope, says the Commission, is a seasoned enterprise whose risks have been minimized. These are the reasons given for prescribing a rate of return of 6½%. They were equally cogent reasons for appraising the physical assets as an assembled whole rather than at their mere original cost.

As indicated elsewhere in this Brief, this is not merely a contest between the utility concerned and consumers in Ohio and Pennsylvania. The contest involves the welfare of West Virginia and its citizens. West Virginia asserts that it was unjust to its welfare to omit from the basic value base, from which both rates and taxes must hereafter be computed, an item of property so long considered legitimate by State and Federal Courts and regulatory commissions, and that no rate thus determined is just and reasonable as required by the Natural Gas Act.

CONCLUSION

From the foregoing discussion in the present Brief as Amicus Curiae, the order of the Federal Power Commission has been shown to be arbitrary and confiscatory, to the extent that the Commission has wholly refused to view the effect of its drastic rulings upon the economy and

well-being of the producing state, considering only the interests of out-of-state consumers. The State of West Virginia urges, therefore, that the judgment of the Circuit Court of Appeals be affirmed, and that these proceedings be returned to the Commission with appropriate directions from this Court that the Natural Gas Act be administered according to the federal nature of the Constitution.

Respectfully submitted,

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Attorneys for West Virginia.

October 19, 1943.

APPENDIX I

Statement Showing That Commission's Order Establishes Well-Mouth Value of Gas at Not Exceeding $.1216 Per M. C. F.

Operating Expenses as Adjusted for Future (FPC Opinion No. 76, p. 54 and 55)	Operating Expenses, (including return) Adjusted for Future (1)	Adjusting Increased Payroll Allowance (2)	Adjusted Operating Expenses (including returns) as Adjusted for Future (3)	Distribution of Adjusted Operating Expenses for Future Production: Wells (4)	Other (5)	Total (6)	Gas Purchased (7)	Trans-mission (8)
Interstate Operating Expenses:								
Natural Gas Production	1,430,102	(114,078)	1,316,024	1,354,011	(37,987)	1,316,024		
Exploration & Development Costs	600,000		600,000	600,000		600,000		
Gas Purchased	8,533,779	8,656	8,542,435				8,542,435	
Transmission Expenses	1,818,335	93,857	1,912,192					1,912,192
Administrative & General Expenses	1,137,094	11,565	1,148,659	298,159	225,570	523,729	42,281	582,649
Depletion	624,440		624,440	624,440		624,440		
Depreciation	835,597		835,597	6,681	353,417	360,098		475,499
Amortization (other)	5,996		5,996	5,996		5,996		
Taxes—State & Misc. Fed.	1,211,012		1,211,012	414,537	234,935	649,472		561,540
Federal Income Tax	76,579		76,579	9,978	2,937	12,915	25,374	38,290
Total Interstate	16,272,934		16,272,934	3,313,802	778,872	4,092,674	8,610,090	3,570,170
Other Gas Revenues	(83,275)		(83,275)	(8,280)		(8,280)		(74,995)
Allocation of Costs to Local W. Va. Sales	(2,694,075)		(2,694,075)	(548,783)	(267,522)	(816,305)	(1,230,653)	(647,117)
Return at 6½% on Interstate Rate Base of 33,712,526	2,191,314		2,191,314	502,195	456,579	958,774		1,232,540
Operating Revenues—Interstate Sales	15,686,898		15,686,898	3,258,934	967,929	4,226,863	7,379,437	4,080,598
Well Mouth Allowance per 26,800,000 mcf produced			.1216¢					
Well Mouth Allowance per 26,800,000 mcf produced excluding exploration and development costs			.0992¢					

APPENDIX II

Reply Brief of City of Cleveland Before the Federal Power Commission

(September 30, 1941)

Table 12, Page 104

DIRECT COSTS OF PRODUCTION OF GAS (EXCLUSIVE OF RETURN) AND INCREMENT OF DIRECT COSTS. YEAR 1940 OVER 1939

	Ex. 67 1939	Exhibit 78 1940	Increment Costs—1940 over 1939
Direct Expenses of Producing Gas, Excl. of Depreciation and Depletion (Ex. 67, pp. 17, 39; Ex. 78, pp. 17, 23)			
734.1 Gas Well Labor	$ 330,338.52	$ 347,147.21	
735.1 Gas Well Supplies and Expenses	130,999.56	164,662.01	
741 Maint. of Prod. Gas Well Equip.	53,457.92	83,242.02	
745 Gas Well Royalties	828,851.62	885,841.27	
Total Direct Gas Well Expenses	1,343,647.62	1,480,892.51	
Gross Production Tax	144,633.15	221,908.58	
Total, Incl. Production Tax	1,448,280.77	1,702,801.09	
Depreciation and Depletion (Ex. 78, p. 54)			
Operated Acreage	$ 36,772.47	$ 57,084.00	
Gas Well Construction	182,755.43	286,492.00	
Cost of Abandoning	69,813.58	105,860.00	
Total Depletion	289,341.48	449,436.00	
Depreciation of Gas Well Equipment (Ex. 61, p. 21; 78, p. 26)	188,482.85	186,702.97	
Total Depreciation and Depletion	$ 477,824.33	$ 636,138.97	
Volume of Gas Produced—M. c. f. (Ex. 78, p. 54)	16,546,230	26,800,000	10,253,770

	Ex. 67 1939	Exhibit 78 1940	Increment Costs—1940 over 1939
Direct Expenses per M.c.f. Produced			
734.1 Gas Well Labor	2.00¢	1.29¢	
735.1 Gas Well Supplies and Expenses	.79	.61	
741 Maint. of Prod. Gas Well Equip.	.32	.31	
745 Gas Well Royalties	5.01	3.31	
Total Direct Gas Well Expenses	8.12	5.52	
Gross Production Tax	.87	.83	
Total, incl. Production Tax	8.99¢	6.35¢	
Depreciation and Depletion Per M. c. f. Produced:			
Depletion	1.75¢	1.68¢	
Depreciation of Gas Well Equipment	1.14	.70	
Total Depreciation and Depletion	2.89¢	2.38¢	
Total Direct Costs of Producing Gas, Incl. Depreciation and Depletion:			
Amount	$1,966,105.10	$ 2,338,940.06	$372,834.96
Per M. c. f. Produced	11.88¢	8.73¢	3.64¢

N. B. It has been the contention of the City of Cleveland, as set forth above, that something over ten million cubic feet of natural gas should be sold by the Hope Company at a unit price of 3.64¢ per M. C. F.

Frankfurter p. 3
Jackson p. 26

SUPREME COURT OF THE UNITED STATES.

Nos. 34 and 35.—October Term, 1943.

Federal Power Commission, City of Akron and Pennsylvania Public Utility Commission, Petitioners, 34 *vs.* Hope Natural Gas Company.	On Writs of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.
City of Cleveland, Petitioner, 35 *vs.* Hope Natural Gas Company.	

[January 3, 1944.]

Mr. Justice Douglas delivered the opinion of the Court.

The primary issue in these cases concerns the validity under the Natural Gas Act of 1938 (52 Stat. 821, 15 U. S. C. § 717) of a rate order issued by the Federal Power Commission reducing the rates chargeable by Hope Natural Gas Co., 44 P. U. R. (N. S.) 1. On a petition for review of the order made pursuant to § 19(b) of the Act, the Circuit Court of Appeals set it aside, one judge dissenting. 134 F. 2d 287. The cases are here on petitions for writs of certiorari which we granted because of the public importance of the questions presented.

Hope is a West Virginia corporation organized in 1898. It is a wholly owned subsidiary of Standard Oil Co. (N. J.). Since the date of its organization, it has been in the business of producing, purchasing and marketing natural gas in that state.[1] It sells some of that gas to local consumers in West Virginia. But the great bulk of it goes to five customer companies which receive it at the West Virginia line and distribute it in Ohio and in Pennsylvania.[2] In July, 1938 the cities of Cleveland and Akron filed complaints with the Commission charging that

[1] Hope produces about one-third of its annual gas requirements and purchases the rest under some 300 contracts.

[2] These five companies are the East Ohio Gas Co., the Peoples Natural Gas Co., the River Gas Co., the Fayette County Gas Co., and the Manufacturers Light & Heat Co. The first three of these companies are, like Hope, sub-

the rates collected by Hope from East Ohio Gas Co. (an affiliate of Hope which distributes gas in Ohio) were excessive and unreasonable. Later in 1938 the Commission on its own motion instituted an investigation to determine the reasonableness of all of Hope's interstate rates. In March 1939 the Public Utility Commission of Pennsylvania filed a complaint with the Commission charging that the rates collected by Hope from Peoples Natural Gas Co. (an affiliate of Hope distributing gas in Pennsylvania) and two non-affiliated companies were unreasonable. The City of Cleveland asked that the challenged rates be declared unlawful and that just and reasonable rates be determined from June 30, 1939 to the date of the Commission's order. The latter finding was requested in aid of state regulation and to afford the Public Utilities Commission of Ohio a proper basis for disposition of a fund collected by East Ohio under bond from Ohio consumers since June 30, 1939. The cases were consolidated and hearings were held.

On May 26, 1942, the Commission entered its order and made its findings. Its order required Hope to decrease its future interstate rates so as to reflect a reduction, on an annual basis, of not less than $3,609,857 in operating revenues. And it established "just and reasonable" average rates per m. c. f. for each of the five customer companies.[3] In response to the prayer of the City of Cleveland the Commission also made findings as to the lawfulness of past rates, although concededly it had no authority under the Act to fix past rates or to award reparations. 44 P. U. R. (N. S.) p. 34. It found that the rates collected by Hope from East Ohio were unjust, unreasonable, excessive and there-

sidiaries of Standard Oil Co. (N. J.). East Ohio and River distribute gas in Ohio, the other three in Pennsylvania. Hope's approximate sales in m. c. f. for 1940 may be classified as follows:

Local West Virginia sales	11,000,000
East Ohio	40,000,000
Peoples	10,000,000
River	400,000
Fayette	860,000
Manufacturers	2,000,000

Hope's natural gas is processed by Hope Construction & Refining Co., an affiliate, for the extraction of gasoline and butane. Domestic Coke Corp., another affiliate, sells coke-oven gas to Hope for boiler fuel.

[3] These required minimum reductions of 7¢ per m. c. f. from the 36.5¢ and 35.5¢ rates previously charged East Ohio and Peoples, respectively, and 3¢ per m. c. f. from the 31.5¢ rate previously charged Fayette and Manufacturers.

fore unlawful, by $830,892 during 1939, $3,219,551 during 1940, and $2,815,789 on an annual basis since 1940. It further found that just, reasonable, and lawful rates for gas sold by Hope to East Ohio for resale for ultimate public consumption were those required to produce $11,528,608 for 1939, $11,507,185 for 1940 and $11,910,947 annually since 1940.

The Commission established an interstate rate base of $33,712,526 which, it found, represented the "actual legitimate cost" of the company's interstate property less depletion and depreciation and plus unoperated acreage, working capital and future net capital additions. The Commission, beginning with book cost, made certain adjustments not necessary to relate here and found the "actual legitimate cost" of the plant in interstate service to be $51,957,416, as of December 31, 1940. It deducted accrued depletion and depreciation, which it found to be $22,328,016 on an "economic-service-life" basis. And it added $1,392,021 for future net capital additions, $566,105 for useful unoperated acreage, and $2,125,000 for working capital. It used 1940 as a test year to estimate future revenues and expenses. It allowed over $16,000,000 as annual operating expenses—about $1,300,000 for taxes, $1,460,000 for depletion and depreciation, $600,000 for exploration and development costs, $8,500,000 for gas purchased. The Commission allowed a net increase of $421,160 over 1940 operating expenses, which amount was to take care of future increase in wages, in West Virginia property taxes, and in exploration and development costs. The total amount of deductions allowed from interstate revenues was $13,495,584.

Hope introduced evidence from which it estimated reproduction cost of the property at $97,000,000. It also presented a so-called trended "original cost" estimate which exceeded $105,000,000. The latter was designed "to indicate what the original cost of the property would have been if 1938 material and labor prices had prevailed throughout the whole period of the piecemeal construction of the company's property since 1898." 44 P. U. R. (N. S.), pp. 8-9. Hope estimated by the "per cent condition" method accrued depreciation at about 35% of reproduction cost new. On that basis Hope contended for a rate base of $66,000,000. The Commission refused to place any reliance on reproduction cost new, saying that it was "not predicated upon facts" ~~and~~ was "too conjectural and illusory to be given any weight in these proceedings." *Id.*, p. 8. It likewise refused to give any

"probative value" to trended "original cost" since it was "not founded in fact" but was "basically erroneous" and produced "irrational results." *Id.*, p. 9. In determining the amount of accrued depletion and depreciation the Commission, following *Lindheimer* v. *Illinois Bell Telephone Co.*, 292 U. S. 151, 167-169; *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575, 592-593, based its computation on "actual legitimate cost". It found that Hope during the years when its business was not under regulation did not observe "sound depreciation and depletion practices" but "actually accumulated an excessive reserve"[4] of about $46,000,000. *Id.*, p. 18. One member of the Commission thought that the entire amount of the reserve should be deducted from "actual legitimate cost" in determining the rate base.[5] The majority of the Commission concluded, however, that where, as here, a business is brought under regulation for the first time and where incorrect depreciation and depletion practices have prevailed, the deduction of the reserve requirement (actual existing depreciation and depletion) rather than the excessive reserve should be made so as to lay "a sound basis for future regulation and control of rates." *Id.*, p. 18. As we have pointed out, it determined accrued depletion and depreciation to be $22,328,016; and it allowed approximately $1,460,000 as the annual operating expense for depletion and depreciation.[6]

[4] The book reserve for interstate plant amounted at the end of 1938 to about $18,000,000 more than the amount determined by the Commission as the proper reserve requirement. The Commission also noted that "twice in the past the company has transferred amounts aggregating $7,500,000 from the depreciation and depletion reserve to surplus. When these latter adjustments are taken into account, the excess becomes $25,500,000, which has been exacted from the ratepayers over and above the amount required to cover the consumption of property in the service rendered and thus to keep the investment unimpaired." 44 P. U. R. (N. S.), p. 22.

[5] That contention was based on the fact that "every single dollar in the depreciation and depletion reserves" was taken "from gross operating revenues whose only source was the amounts charged customers in the past for natural gas. It is, therefore, a fact that the depreciation and depletion reserves have been contributed by the customers and do not represent any investment by Hope." *Id.*, p. 40. And see Railroad Commission *v.* Cumberland Tel. & T. Co., 212 U. S. 414, 424-425; 2 Bonbright, Valuation of Property (1937), p. 1139.

[6] The Commission noted that the case was "free from the usual complexities involved in the estimate of gas reserves because the geologists for the company and the Commission presented estimates of the remaining recoverable gas reserves which were about one per cent apart." 44 P. U. R. (N. S.), pp. 19-20.

The Commission utilized the "straight-line-basis" for determining the depreciation and depletion reserve requirements. It used estimates of the

Hope's estimate of original cost was about $69,735,000—approximately $17,000,000 more than the amount found by the Commission. The item of $17,000,000 was made up largely of expenditures which prior to December 31, 1938, were charged to operating expenses. Chief among those expenditures was some $12,600,000 expended in well-drilling prior to 1923. Most of that sum was expended by Hope for labor, use of drilling-rigs, hauling, and similar costs of well-drilling. Prior to 1923 Hope followed the general practice of the natural gas industry and charged the cost of drilling wells to operating expenses. Hope continued that practice until the Public Service Commission of West Virginia in 1923 required it to capitalize such expenditures, as does the Commission under its present Uniform System of Accounts.[7] The Commission refused to add such items to the rate base stating that "No greater injustice to consumers could be done than to allow items as operating expenses and at a later date include them in the rate base, thereby placing multiple charges upon the consumers." *Id.*, p. 12. For the same reason the Commission excluded from the rate base about $1,600,000 of expenditures on properties which Hope acquired from other utilities, the latter having charged those payments to operating expenses. The Commission disallowed certain other overhead items amounting to over $3,000,000 which also had been previously charged to operating expenses. And it refused to add some $632,000 as interest during construction since no interest was in fact paid.

Hope contended that it should be allowed a return of not less than 8%. The Commission found that an 8% return would be unreasonable but that 6½% was a fair rate of return. That rate of return, applied to the rate base of $33,712,526, would

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average service lives of the property by classes based in part on an inspection of the physical condition of the property. And studies were made of Hope's retirement experience and maintenance policies over the years. The average service lives of the various classes of property were converted into depreciation rates and then applied to the cost of the property to ascertain the portion of the cost which had expired in rendering the service.

The record in the present case shows that Hope is on the lookout for new sources of supply of natural gas and is contemplating an extension of its pipe line into Louisiana for that purpose. The Commission recognized in fixing the rates of depreciation that much material may be used again when various present sources of gas supply are exhausted, thus giving that property more than scrap value at the end of its present use.

[7] See Uniform System of Accounts prescribed for Natural Gas Companies effective January 1, 1940, Account No. 332.1.

produce $2,191,314 annually, as compared with the present income of not less than $5,801,171.

The Circuit Court of Appeals set aside the order of the Commission for the following reasons. (1) It held that the rate base should reflect the "present fair value" of the property, that the Commission in determining the "value" should have considered reproduction cost and trended original cost, and that "actual legitimate cost" (prudent investment) was not the proper measure of "fair value" where price levels had changed since the investment. (2) It concluded that the well-drilling costs and overhead items in the amount of some $17,000,000 should have been included in the rate base. (3) It held that accrued depletion and depreciation and the annual allowance for that expense should be computed on the basis of "present fair value" of the property not on the basis of "actual legitimate cost".

The Circuit Court of Appeals also held that the Commission had no power to make findings as to past rates in aid of state regulation. But it concluded that those findings were proper as a step in the process of fixing future rates. Viewed in that light, however, the findings were deemed to be invalidated by the same errors which vitiated the findings on which the rate order was based.

Order Reducing Rates. Congress has provided in § 4(a) of the Natural Gas Act that all natural gas rates subject to the jurisdiction of the Commission "shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful." Sec. 5(a) gives the Commission the power, after hearing, to determine the "just and reasonable rate" to be thereafter observed and to fix the rate by order. Sec. 5(a) also empowers the Commission to order a "decrease where existing rates are unjust . . . unlawful, or are not the lowest reasonable rates." And Congress has provided in § 19(b) that on review of these rate orders the "finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." Congress, however, has provided no formula by which the "just and reasonable" rate is to be determined. It has not filled in the details of the general prescription[8] of § 4(a)

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[8] Sec. 6 of the Act comes the closest to supplying any definite criteria for rate making. It provides in subsection (a) that, "The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such

and § 5(a). It has not expressed in a specific rule the fixed principle of "just and reasonable".

When we sustained the constitutionality of the Natural Gas Act in the *Natural Gas Pipeline Co.* case, we stated that the "authority of Congress to regulate the prices of commodities in interstate commerce is at least as great under the Fifth Amendment as is that of the States under the Fourteenth to regulate the prices of commodities in intrastate commerce." 315 U. S. p. 582. Rate-making is indeed but one species of price-fixing. *Munn* v. *Illinois,* 94 U. S. 113, 134. The fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean that the regulation is invalid. *Block* v. *Hirsh,* 256 U. S. 135, 155-157; *Nebbia* v. *New York,* 291 U. S. 502, 523-539 and cases cited. It does, however, indicate that "fair value" is the end product of the process of rate-making not the starting point as the Circuit Court of Appeals held. The heart of the matter is that rates cannot be made to depend upon "fair value" when the value of the going enterprise depends on earnings under whatever rates may be anticipated.[9]

We held in *Federal Power Commission* v. *Natural Gas Pipeline Co., supra,* that the Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of "pragmatic adjustments." *Id.,* p. 586. And when the Commission's order is challenged in the courts, the question is whether that order "viewed in its entirety" meets the requirements of the Act. *Id.,* p. 586. Under the statutory standard of "just and reasonable" it is the result reached not the method employed which is controlling. Cf. *Los Angeles Gas & Electric Corp.* v. *Railroad Commission,* 289 U. S. 287, 304-305, 314; *West Ohio Gas Co.* v. *Commission* (No. 1), 294 U. S. 63, 70; *West* v. *Chesapeake & Potomac Tel.*

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cost or depreciation and the fair value of such property." Subsection (b) provides that every natural-gas company on request shall file with the Commission a statement of the "original cost" of its property and shall keep the Commission informed regarding the "cost" of all additions, etc.

[9] We recently stated that the meaning of the word "value" is to be gathered "from the purpose for which a valuation is being made. Thus the question in a valuation for rate making is how much a utility will be allowed to earn. The basic question in a valuation for reorganization purposes is how much the enterprise in all probability can earn." Institutional Investors v. Chicago, M., St. P. & P. R. Co., 318 U. S. 523, 540.

Co., 295 U. S. 662, 692-693 (dissenting opinion). It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important. Moreover, the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences. Cf. *Railroad Commission* v. *Cumberland Tel. & T. Co.*, 212 U. S. 414; *Lindheimer* v. *Illinois Tel. Co., supra*, pp. 164, 169; *Railroad Commission* v. *Pacific Gas & E. Co.*, 302 U. S. 388, 401.

The rate-making process under the Act, i. e., the fixing of "just and reasonable" rates, involves a balancing of the investor and the consumer interests. Thus we stated in the *Natural Gas Pipeline Co.* case that "regulation does not insure that the business shall produce net revenues." 315 U. S. p. 590. But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. Cf. *Chicago & Grand Trunk Ry. Co.* v. *Wellman*, 143 U. S. 339, 345-346. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. See *Missouri ex rel. Southwestern Bell Tel. Co.* v. *Public Service Commission*, 262 U. S. 276, 291 (Mr. Justice Brandeis concurring). The conditions under which more or less might be allowed are not important here. Nor is it important to this case to determine the various permissible ways in which any rate base on which the return is computed might be arrived at. For we are of the view that the end result in this case cannot be condemned under the Act as unjust and unreasonable from the investor or company viewpoint.

We have already noted that Hope is a wholly owned subsidiary of the Standard Oil Co. (N. J.). It has no securities outstanding except stock. All of that stock has been owned by Standard since 1908. The par amount presently outstanding is approximately $28,000,000 as compared with the rate base of $33,712,526 established by the Commission. Of the total outstanding stock $11,-000,000 was issued in stock dividends. The balance, or about $17,-000,000, was issued for cash or other assets. During the four decades of its operations Hope has paid over $97,000,000 in cash dividends. It had, moreover, accumulated by 1940 an earned surplus of about $8,000,000. It had thus earned the total investment in the company nearly seven times. Down to 1940 it earned over 20% per year on the average annual amount of its capital stock issued for cash or other assets. On an average invested capital of some $23.000.000 Hope's average earnings have been about 12% a year. And during this period it had accumulated in addition reserves for depletion and depreciation of about $46,000,000. Furthermore, during 1939, 1940 and 1941, Hope paid dividends of 10% on its stock. And in the year 1942, during about half of which the lower rates were in effect, it paid dividends of 7½%. From 1939-1942 its earned surplus increased from $5,250,000 to about $13,700,000, i. e., to almost half the par value of its outstanding stock.

As we have noted, the Commission fixed a rate of return which permits Hope to earn $2,191,314 annually. In determining that amount it stressed the importance of maintaining the financial integrity of the company. It considered the financial history of Hope and a vast array of data bearing on the natural gas industry, related businesses, and general economic conditions. It noted that the yields on better issues of bonds of natural gas companies sold in the last few years were "close to 3 per cent", 44 P. U. R. (N. S.), p. 33. It stated that the company was a "seasoned enterprise whose risks have been minimized" by adequate provisions for depletion and depreciation (past and present) with "concurrent high profits", by "protected established markets, through affiliated distribution companies, in populous and industralized areas", and by a supply of gas locally to meet all requirements, "except on certain peak days in the winter, which it is feasible to supplement in the future with gas from other sources." *Id.*, p. 33. The Commission concluded, "The company's efficient management, established markets, financial rec-

ord, affiliations, and its prospective business place it in a strong position to attract capital upon favorable terms when it is required." *Id.*, p. 33.

In view of these various considerations we cannot say that an annual return of $2,191,314 is not "just and reasonable" within the meaning of the Act. Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so-called "fair value" rate base. In that connection it will be recalled that Hope contended for a rate base of $66,000,000 computed on reproduction cost new. The Commission points out that if that rate base were accepted, Hope's average rate of return for the four-year period from 1937-1940 would amount to 3.27%. During that period Hope earned an annual average return of about 9% on the average investment. It asked for no rate increases. Its properties were well maintained and operated. As the Commission says such a modest rate of 3.27% suggests an "inflation of the base on which the rate has been computed." *Dayton Power & Light Co.* v. *Public Utilities Commission*, 292 U. S. 290, 312. Cf. *Lindheimer* v. *Illinois Bell Tel. Co., supra,* p. 164. The incongruity between the actual operations and the return computed on the basis of reproduction cost suggests that the Commission was wholly justified in rejecting the latter as the measure of the rate base.

In view of this disposition of the controversy we need not stop to inquire whether the failure of the Commission to add the $17,000,000 of well-drilling and other costs to the rate base was consistent with the prudent investment theory as developed and applied in particular cases.

Only a word need be added respecting depletion and depreciation. We held in the *Natural Gas Pipeline Co.* case that there was no constitutional requirement "that the owner who embarks in a wasting-asset business of limited life shall receive at the end more than he has put into it." 315 U. S. p. 593. The Circuit Court of Appeals did not think that that rule was applicable here because Hope was a utility required to continue its service to the public and not scheduled to end its business on a day certain as was stipulated to be true of the Natural Gas Pipeline

Co. But that distinction is quite immaterial. The ultimate exhaustion of the supply is inevitable in the case of all natural gas companies. Moreover, this Court recognized in *Lindheimer* v. *Illinois Bell Tel. Co., supra*, the propriety of basing annual depreciation on cost.[10] By such a procedure the utility is made whole and the integrity of its investment maintained.[11] No more is required.[12] We cannot approve the contrary holding of *United Railways* v. *West*, 280 U. S. 234, 253-254. Since there are no constitutional requirements more exacting than the standards of the Act, a rate order which conforms to the latter does not run afoul of the former.

The Position of West Virginia. The State of West Virginia, as well as its Public Service Commission, intervened in the proceedings before the Commission and participated in the hearings before it. They have also filed a brief *amicus curiae* here and have participated in the argument at the bar. Their contention is that the result achieved by the rate order "brings consequences which are unjust to West Virginia and its citizens" and which "unfairly depress the value of gas, gas lands and gas leaseholds, unduly restrict development of their natural resources, and arbitrarily transfer their properties to the residents of other states without just compensation therefor."

West Virginia points out that the Hope Natural Gas Co. holds a large number of leases on both producing and unoperated properties. The owner or grantor receives from the operator or grantee delay rentals as compensation for postponed drilling. When a producing well is successfully brought in, the gas lease custo-

10 Chief Justice Hughes said in that case (292 U. S. pp. 168-169): "If the predictions of service life were entirely accurate and retirements were made when and as these predictions were precisely fulfilled, the depreciation reserve would represent the consumption of capital, on a cost basis, according to the method which spreads that loss over the respective service periods. But if the amounts charged to operating expenses and credited to the account for depreciation reserve are excessive, to that extent subscribers for the telephone service are required to provide, in effect, capital contributions, not to make good losses incurred by the utility in the service rendered and thus to keep its investment unimpaired, but to secure additional plant and equipment upon which the utility expects a return."

11 See Mr. Justice Brandeis (dissenting) in United Railways v. West, 280 U. S. 234, 259-288, for an extended analysis of the problem.

12 It should be noted that the Act provides no specific rule governing depletion and depreciation. Sec. 9(a) merely states that the Commission "may from time to time ascertain and determine, and by order fix, the proper and adequate rates of depreciation and amortization of the several classes of property of each natural-gas company used or useful in the production, transportation, or sale of natural gas."

marily continues indefinitely for the life of the field. In that case the operator pays a stipulated gas-well rental or in some cases a gas royalty equivalent to one-eighth of the gas marketed.[13] Both the owner and operator have valuable property interests in the gas which are separately taxable under West Virginia law. The contention is that the reversionary interests in the leaseholds should be represented in the rate proceedings since it is their gas which is being sold in interstate commerce. It is argued, moreover, that the owners of the reversionary interests should have the benefit of the "discovery value" of the gas leaseholds, not the interstate consumers. Furthermore, West Virginia contends that the Commission in fixing a rate for natural gas produced in that State should consider the effect of the rate order on the economy of West Virginia. It is pointed out that gas is a wasting asset with a rapidly diminishing supply. As a result West Virginia's gas deposits are becoming increasingly valuable. Nevertheless the rate fixed by the Commission reduces that value. And that reduction, it is said, has severe repercussions on the economy of the State. It is argued in the first place that as a result of this rate reduction Hope's West Virginia property taxes may be decreased in view of the relevance which earnings have under West Virginia law in the assessment of property for tax purposes.[14] Secondly, it is pointed out that West Virginia has a production tax[15] on the "value" of the gas exported from the State. And we are told that for purposes of that tax "value" becomes under West Virginia law "practically the substantial equivalent of market value." Thus West Virginia argues that undervaluation of Hope's gas leaseholds will cost the State many thousands of dollars in taxes. The effect, it is urged, is to impair West Virginia's tax structure for the benefit of Ohio and Pennsylvania consumers. West Virginia emphasizes, moreover, its deep interest in the conservation of its natural resources including its natural gas. It says that a reduction of the value of these leasehold values will jeopardize these conservation policies in three respects: (1) exploratory development of new fields will be discouraged; (2) abandonment of low-yield high-cost marginal wells will be hastened;

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13 See Simonton, The Nature of the Interest of the Grantee Under an Oil and Gas Lease (1918), 25 W. Va. L. Quar. 295.

14 West Penn Power Co. v. Board of Review, 112 W. Va. 442.

15 W. Va. Rev. Code of 1943, ch. 11, Art. 13, §§ 2a, 3a.

and (3) secondary recovery of oil will be hampered. Furthermore, West Virginia contends that the reduced valuation will harm one of the great industries of the State and that harm to that industry must inevitably affect the welfare of the citizens of the State. It is also pointed out that West Virginia has a large interest in coal and oil as well as in gas and that these forms of fuel are competitive. When the price of gas is materially cheapened, consumers turn to that fuel in preference to the others. As a result this lowering of the price of natural gas will have the effect of depreciating the price of West Virginia coal and oil.

West Virginia insists that in neglecting this aspect of the problem the Commission failed to perform the function which Congress entrusted to it and that the case should be remanded to the Commission for a modification of its order.[16]

We have considered these contentions at length in view of the earnestness with which they have been urged upon us. We have searched the legislative history of the Natural Gas Act for any indication that Congress entrusted to the Commission the various considerations which West Virginia has advanced here. And our conclusion is that Congress did not.

We pointed out in *Illinois Natural Gas Co.* v. *Public Service Co.*, 314 U. S. 498, 506, that the purpose of the Natural Gas Act was to provide, "through the exercise of the national power over interstate commerce, an agency for regulating the wholesale distribution to public service companies of natural gas moving interstate, which this Court had declared to be interstate commerce not subject to certain types of state regulation." As stated in the House Report the "basic purpose" of this legislation was "to occupy" the field in which such cases as *Missouri* v. *Kansas Gas Co.*, 265 U. S. 298, and *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, 273 U. S. 83, had held the States might not act. H. Rep. No. 709, 75th Cong., 1st Sess., p. 2. In accomplishing that purpose the bill was designed to take "no authority from State commissions" and was "so drawn as to complement and in no manner usurp State regulatory authority." *Id.*, p. 2. And the Federal Power Commission was given no authority over the "production or gathering of natural gas." § 1(b).

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16 West Virginia suggests as a possible solution (1) that a "going concern value" of the company's tangible assets be included in the rate base and (2) that the fair market value of gas delivered to customers be added to the outlay for operating expenses and taxes.

The primary aim of this legislation was to protect consumers against exploitation at the hands of natural gas companies. Due to the hiatus in regulation which resulted from the *Kansas Gas Co.* case and related decisions state commissions found it difficult or impossible to discover what it cost interstate pipe-line companies to deliver gas within the consuming states; and thus they were thwarted in local regulation. H. Rep., No. 709, *supra,* p. 3. Moreover, the investigations of the Federal Trade Commission had disclosed that the majority of the pipe-line mileage in the country used to transport natural gas, together with an increasing percentage of the natural gas supply for pipe-line transportation, had been acquired by a handful of holding companies.[17] State commissions, independent producers, and communities having or seeking the service were growing quite helpless against these combinations.[18] These were the types of problems with which those participating in the hearings were pre-occupied.[19] Congress addressed itself to those specific evils.

The Federal Power Commission was given broad powers of regulation. The fixing of "just and reasonable" rates (§ 4) with the powers attendant thereto[20] was the heart of the new regulatory system. Moreover, the Commission was given certain authority by § 7(a), on a finding that the action was necessary or desirable "in the public interest," to require natural gas companies to extend or improve their transportation facilities and to sell gas to any authorized local distributor. By § 7(b) it was given control over the abandonment of facilities or of service. And by § 7(c), as originally enacted, no natural gas company could undertake the construction or extension of any facilities for the transportation of natural gas to a market in which natural gas was already being served by another company, or sell any natural gas in such a market, without obtaining a certificate of public convenience and necessity from the Commission. In passing on such applications for

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17 S. Doc. 92, Pt. 84-A, ch. XII, Final Report, Federal Trade Commission to the Senate pursuant to S. Res. No. 83, 70th Cong., 1st Sess.

18 S. Doc. 92, Pt. 84-A, chs. XII, XIII, *op. cit., supra,* note 17.

19 See Hearings on H. R. 11662, Subcommittee of House Committee on Interstate & Foreign Commerce, 74th Cong., 2d Sess.; Hearings on H. R. 4008, House Committee on Interstate & Foreign Commerce, 75th Cong., 1st Sess.

20 The power to investigate and ascertain the "actual legitimate cost" of property (§ 6), the requirement as to books and records (§ 8), control over rates of depreciation (§ 9), the requirements for periodic and special reports (§ 10), the broad powers of investigation (§ 14) are among the chief powers supporting the rate making function.

certificates of convenience and necessity the Commission was told by § 7(c); as originally enacted, that it was "the intention of Congress that natural gas shall be sold in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial, or any other use at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest." The latter provision was deleted from § 7(c) when that subsection was amended by the Act of February 7, 1942, 56 Stat. 83. By that amendment limited grandfather rights were granted companies desiring to extend their facilities and services over the routes or within the area which they were already serving. Moreover, § 7(c) was broadened so as to require certificates of public convenience and necessity not only where the extensions were being made to markets in which natural gas was already being sold by another company but in other situations as well.

These provisions were plainly designed to protect the consumer interests against exploitation at the hands of private natural gas companies. When it comes to cases of abandonment or of extensions of facilities or service, we may assume that, apart from the express exemptions[21] contained in § 7, considerations of conservation are material to the issuance of certificates of public convenience and necessity. But the Commission was not asked here for a certificate of public convenience and necessity under § 7 for any proposed construction or extension. It was faced with a determination of the amount which a private operator should be allowed to earn from the sale of natural gas across state lines through an established distribution system. Secs. 4 and 5, not § 7, provide the standards for that determination. We cannot find in the words of the Act or in its history the slightest intimation or suggestion that the exploitation of consumers by private operators through the maintenance of high rates should be allowed to continue provided the producing states obtain indirect benefits from it. That apparently was the Commission's view of the matter, for the same arguments advanced here were presented to the Commission and not adopted by it.

We do not mean to suggest that Congress was unmindful of the interests of the producing states in their natural gas supplies

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[21] Apart from the grandfather clause contained in § 7(c), there is the provision of § 7(f) that a natural gas company may enlarge or extend its facilities within the "service area" determined by the Commission without any further authorization.

when it drafted the Natural Gas Act. As we have said, the Act does not intrude on the domain traditionally reserved for control by state commissions; and the Federal Power Commission was given no authority over "the production or gathering of natural gas." § 1(b). In addition, Congress recognized the legitimate interests of the States in the conservation of natural gas. By § 11 Congress instructed the Commission to make reports on compacts between two or more States dealing with the conservation, production and transportation of natural gas.[22] The Commission was also directed to recommend further legislation appropriate or necessary to carry out any proposed compact and "to aid in the conservation of natural-gas resources within the United States and in the orderly, equitable, and economic production, transportation, and distribution of natural gas." § 11(a). Thus Congress was quite aware of the interests of the producing states in their natural gas supplies.[23] But it left the protection of those interests to measures other than the maintenance of high rates to private companies. If the Commission is to be compelled to let the stockholders of natural gas companies have a feast so that the

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[22] See P. L. 117, approved July 7, 1943, containing an "Interstate Compact to Conserve Oil and Gas" between Oklahoma, Texas, New Mexico, Illinois, Colorado, and Kansas.

[23] As we have pointed out, § 7(c) was amended by the Act of February 7, 1942 (56 Stat. 83) so as to require certificates of public convenience and necessity not only where the extensions were being made to markets in which natural gas was already being sold by another company but to other situations as well. Considerations of conservation entered into the proposal to give the Act that broader scope. H. Rep. No. 1290, 77th Cong., 1st Sess., pp. 2-3. And see Annual Report, Federal Power Commission (1940) pp. 79, 80; Baum, The Federal Power Commission and State Utility Regulation (1942), p. 261.

The bill amending § 7(c) originally contained a subsection (h) reading as follows: "Nothing contained in this section shall be construed to affect the authority of a State within which natural gas is produced to authorize or require the construction or extension of facilities for the transportation and sale of such gas within such State: Provided, however, That the Commission, after a hearing upon complaint or upon its own motion, may by order forbid any intrastate construction or extension by any natural-gas company which it shall find will prevent such company from rendering adequate service to its customers in interstate or foreign commerce in territory already being served." See Hearings on H. R. 5249, House Committee on Interstate & Foreign Commerce, 77th Cong., 1st Sess., pp. 7, 11, 21, 29, 32-33. In explanation of its deletion the House Committee Report stated, pp. 4-5: "The increasingly important problems raised by the desire of several States to regulate the use of the natural gas produced therein in the interest of consumers within such States, as against the Federal power to regulate interstate commerce in the interest of both interstate and intrastate consumers, are deemed by the committee to warrant further intensive study and probably a more detailed and comprehensive plan for the handling thereof than that which would have been provided by the stricken subsection."

producing states may receive crumbs from that table, the present Act must be redesigned. Such a project raises questions of policy which go beyond our province.

It is hardly necessary to add that a limitation on the net earnings of a natural gas company from its interstate business is not a limitation on the power of the producing state either to safeguard its tax revenues from that industry[24] or to protect the interests of those who sell their gas to the interstate operator.[25] The return which the Commission allowed was the net return after all such charges.

It is suggested that the Commission has failed to perform its duty under the Act in that it has not allowed a return for gas production that will be enough to induce private enterprise to perform completely and efficiently its functions for the public. The Commission, however, was not oblivious of those matters. It considered them. It allowed, for example, delay rentals and exploration and development costs in operating expenses.[26] No serious attempt has been made here to show that they are inadequate. We certainly cannot say that they are, unless we are to substitute our opinions for the expert judgment of the administrators to whom Congress entrusted the decision. Moreover, if in light of experience they turn out to be inadequate for development of new sources of supply, the doors of the Commission are open for increased allowances. This is not an order for all time. The Act contains machinery for obtaining rate adjustments. § 4.

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24 We have noted that in the annual operating expenses of some $16,000,000 the Commission included West Virginia and federal taxes. And in the net increase of $421,160 over 1940 operating expenses allowed by the Commission was some $80,000 for increased West Virginia property taxes. The adequacy of these amounts has not been challenged here.

25 The Commission included in the aggregate annual operating expenses which it allowed some $8,500,000 for gas purchased. It also allowed about $1,400,000 for natural gas production and about $600,000 for exploration and development.

It is suggested, however, that the Commission in ascertaining the cost of Hope's natural gas production plant proceeded contrary to § 1(b) which provides that the Act shall not apply to "the production or gathering of natural gas". But such valuation, like the provisions for operating expenses, is essential to the rate-making function as customarily performed in this country. Cf. Smith, The Control of Power Rates in the United States and England (1932), 159 The Annals 101. Indeed § 14(b) of the Act gives the Commission the power to "determine the propriety and reasonableness of the inclusion in operating expenses, capital, or surplus of all delay rentals or other forms of rental or compensation for unoperated lands and leases."

26 See note 25, *supra*.

But it is said that the Commission placed too low a rate on gas for industrial purposes as compared with gas for domestic purposes and that industrial uses should be discouraged. It should be noted in the first place that the rates which the Commission has fixed are Hope's interstate wholesale rates to distributors not interstate rates to industrial users[27] and domestic consumers. We hardly can assume, in view of the history of the Act and its provisions, that the resales intrastate by the customer companies which distribute the gas to ultimate consumers in Ohio and Pennsylvania are subject to the rate-making powers of the Commission.[28] But in any event those rates are not in issue here. Moreover, we fail to find in the power to fix "just and reasonable" rates the power to fix rates which will disallow or discourage resales for industrial use. The Committee Report stated that the Act provided "for regulation along recognized and more or less standardized lines" and that there was "nothing novel in its provisions". H. Rep. No. 709, *supra*, p. 3. Yet if we are now to tell the Commission to fix the rates so as to discourage particular uses, we would indeed be injecting into a rate case a "novel" doctrine which has no express statutory sanction. The same would be true if we were to hold that the wasting-asset nature of the industry required the maintenance of the level of rates so that natural gas companies could make a greater profit on each unit of gas sold. Such theories of rate-making for this industry may or may not be desirable. The difficulty is that § 4(a) and § 5(a) contain only the conventional standards of rate-making for natural gas companies.[29] The Act of February 7, 1942, by broadening § 7 gave

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[27] The Commission has expressed doubts over its power to fix rates on "direct sales to industries" from interstate pipelines as distinguished from "sales for resale to the industrial customers of distributing companies." Annual Report, Federal Power Commission (1940), p. 11.

[28] Sec. 1(b) of the Act provides: "The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas." And see § 2(6), defining a "natural-gas company", and H. Rep. No. 709, *supra*, pp. 2, 3.

[29] The wasting-asset characteristic of the industry was recognized prior to to the Act as requiring the inclusion of a depletion allowance among operating expenses. See Columbus Gas & Fuel Co. v. Public Utilities Commission, 292 U. S. 398, 404-405. But no such theory of rate-making for natural gas companies as is now suggested emerged from the cases arising during the earlier period of regulation.

the Commission some additional authority to deal with the conservation aspects of the problem.[30] But § 4(a) and § 5(a) were not changed. If the standard of "just and reasonable" is to sanction the maintenance of high rates by a natural gas company because they restrict the use of natural gas for certain purposes, the Act must be further amended.

It is finally suggested that the rates charged by Hope are discriminatory as against domestic users and in favor of industrial users. That charge is apparently based on § 4(b) of the Act which forbids natural gas companies from maintaining "any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service." The power of the Commission to eliminate any such unreasonable differences or discriminations is plain. § 5(a). The Commission, however, made no findings under § 4(b). Its failure in that regard was not challenged in the petition to review. And it has not been raised or argued here by any party. Hence the problem of discrimination has no proper place in the present decision. It will be time enough to pass on that issue when it is presented to us. Congress has entrusted the administration of the Act to the Commission not to the courts. Apart from the requirements of judicial review it is not for us to advise the Commission how to discharge its functions.

Findings as to the Lawfulness of Past Rates. As we have noted, the Commission made certain findings as to the lawfulness of past rates which Hope had charged its interstate customers. Those findings were made on the complaint of the City of Cleveland and in aid of state regulation. It is conceded that under the Act the Commission has no power to make reparation orders. And its power to fix rates admittedly is limited to those "to be thereafter observed and in force." § 5(a). But the Commission maintains that it has the power to make findings as to the lawful-

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30 The Commission has been alert to the problems of conservation in its administration of the Act. It has indeed suggested that it might be wise to restrict the use of natural gas "by functions rather than by areas." Annual Report (1940) p. 79.

The Commission stated in that connection that natural gas was particularly adapted to certain industrial uses. But it added that the general use of such gas "under boilers for the production of steam" is "under most circumstances of very questionable social economy." *Ibid.*

ness of past rates even though it has no power to fix those rates.[31] However that may be, we do not think that these findings were reviewable under § 19(b) of the Act. That section gives any party "aggrieved by an order" of the Commission a review "of such order" in the circuit court of appeals for the circuit where the natural gas company is located or has its principal place of business or in the United States Court of Appeals for the District of Columbia. We do not think that the findings in question fall within that category.

The Court recently summarized the various types of administrative action or determination reviewable as orders under the Urgent Deficiencies Act of October 22, 1913, 28 U. S. C. §§ 45, 47a, and kindred statutory provisions. *Rochester Tel. Corp.* v. *United States,* 307 U. S. 125. It was there pointed out that where "the order sought to be reviewed does not of itself adversely affect complainant but only affects his rights adversely on the contingency of future administrative action", it is not reviewable. *Id.*, p. 130. The Court said, "In view of traditional conceptions of federal judicial power, resort to the courts in these situations is either premature or wholly beyond their province." *Id.*, p. 130. And see *United States* v. *Los Angeles & S. L. R. Co.,* 273 U. S. 299, 309, 310; *Shannahan* v. *United States,* 303 U. S. 596. These considerations are apposite here. The Commission has no authority to enforce these findings. They are "the exercise solely of the function of investigation." *United States* v. *Los Angeles & S. L. R. Co., supra,* p. 310. They are only a preliminary, interim step towards possible future action—action not by the Commission but by wholly independent agencies. The outcome of those proceedings may turn on factors other than these findings. These findings may never result in the respondent feeling the pinch of administrative action.

Reversed.

Mr. Justice ROBERTS took no part in the consideration or decision of this case.

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31 The argument is that § 4(a) makes "unlawful" the charging of any rate that is not just and reasonable. And § 14(a) gives the Commission power to investigate any matter "which it may find necessary or proper in order to determine whether any person has violated" any provision of the Act. Moreover, § 5(b) gives the Commission power to investigate and determine the cost of production or transportation of natural gas in cases where it has "no authority to establish a rate governing the transportation or sale of such natural gas." And § 17(c) directs the Commission "to make available to the several State commissions such information and reports as may be of assistance in State regulation of natural-gas companies." For a discussion of these points by the Commission see 44 P. U. R. (N. S.) pp. 34-35.

SUPREME COURT OF THE UNITED STATES.

Nos. 34 and 35.—October Term, 1943.

Federal Power Commission, City of Akron and Pennsylvania Public Utility Commission, Petitioners, 34 *vs.* Hope Natural Gas Company.	On Writs of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.
City of Cleveland, Petitioner, 35 *vs.* Hope Natural Gas Company.	

[January 3, 1944.]

Opinion of Mr. Justice Black and Mr. Justice Murphy.

We agree with the Court's opinion and would add nothing to what has been said but for what is patently a wholly gratuitous assertion as to Constitutional law in the dissent of Mr. Justice Frankfurter. We refer to the statement that "Congressional acquiescence to date in the doctrine of *Chicago, etc., Railway Co.* v. *Minnesota, supra,* may fairly be claimed." That was the case in which a majority of this Court was finally induced to expand the meaning of "due process" so as to give courts power to block efforts of the state and national governments to regulate economic affairs. The present case does not afford a proper occasion to discuss the soundness of that doctrine because, as stated in Mr. Justice Frankfurter's dissent, "That issue is not here in controversy." The salutary practice whereby courts do not discuss issues in the abstract applies with peculiar force to Constitutional questions. Since, however, the dissent adverts to a highly controversial due process doctrine and implies its acceptance by Congress, we feel compelled to say that we do not understand that Congress voluntarily has acquiesced in a Constitutional principle of government that courts, rather than legislative bodies, possess final authority over regulation of economic affairs. Even this Court has not always fully embraced that principle, and we wish to repeat that we have never acquiesced in it, and do not now. See *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575, 599-601.

SUPREME COURT OF THE UNITED STATES.

Nos. 34 and 35.—October Term, 1943.

Federal Power Commission, City of Akron and Pennsylvánia Public Utility Commission, Petitioners, 34 *vs.* Hope Natural Gas Company. City of Cleveland, Petitioner, 35 *vs.* Hope Natural Gas Company.	On Writs of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[January 3, 1944.]

Mr. Justice Reed, dissenting.

This case involves the problem of rate making under the Natural Gas Act. Added importance arises from the obvious fact that the principles stated are generally applicable to all federal agencies which are entrusted with the determination of rates for utilities. Because my views differ somewhat from those of my brethren, it may be of some value to set them out in a summary form.

The Congress may fix utility rates in situations subject to federal control without regard to any standard except the constitutional standards of due process and for taking private property for public use without just compensation. *Wilson* v. *New*, 243 U. S. 332, 350. A Commission, however, does not have this freedom of action. Its powers are limited not only by the constitutional standards but also by the standards of the delegation. Here the standard added by the Natural Gas Act is that the rate be "just and reasonable."[1] Section 6[2] throws additional light on the meaning of these words.

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1 Natural Gas Act, § 4(a), 52 Stat. 821, 822, 15 U. S. C. § 717(a).

2 52 Stat. 821, 824, 15 U. S. C. § 717e:

"(a) The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear

When the phrase was used by Congress to describe allowable rates, it had relation to something ascertainable. The rates were not left to the whim of the Commission. The rates fixed would produce an annual return and that annual return was to be compared with a theoretical just and reasonable return, all risks considered, on the fair value of the property used and useful in the public service at the time of the determination.

Such an abstract test is not precise. The agency charged with its determination has a wide range before it could properly be said by a court that the agency had disregarded statutory standards or had confiscated the property of the utility for public use. Cf. *Chicago, M. & St. P. Ry.* v. *Minnesota,* 134 U. S. 418, 461-66, dissent. This is as Congress intends. Rates are left to an experienced agency particularly competent by training to appraise the amount required.

The decision as to a reasonable return had not been a source of great difficulty, for borrowers and lenders reached such agreements daily in a multitude of situations; and although the determination of fair value had been troublesome, its essentials had been worked out in fairness to investor and consumer by the time of the enactment of this Act. Cf. *Los Angeles G. & E. Corp.* v. *Railroad Com.,* 289 U. S. 287, 304 *et seq.* The results were well known to Congress and had that body desired to depart from the traditional concepts of fair value and earnings, it would have stated its intention plainly. *Helvering* v. *Griffiths,* 318 U. S. 371.

It was already clear that when rates are in dispute, "earnings produced by rates do not afford a standard for decision." 289 U. S. at 305. Historical cost, prudent investment and reproduction cost[3] were all relevant factors in determining fair value. In-

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on the determination of such cost or depreciation and the fair value of such property.

"(b) Every natural-gas company upon request shall file with the Commission an inventory of all or any part of its property and a statement of the original cost thereof, and shall keep the Commission informed regarding the cost of all additions, betterments, extensions, and new construction."

[3] "Reproduction cost" has been variously defined, but for rate making purposes the most useful sense seems to be, the minimum amount necessary to create at the time of the inquiry a modern plant capable of rendering equivalent service. See I Bonbright, Valuation of Property (1937) 152. Reproduction cost as the cost of building a replica of an obsolescent plant is not of real significance.

"Prudent investment" is not defined by the Court. It may mean the sum originally put in the enterprise, either with or without additional amounts from excess earnings reinvested in the business.

deed, disregarding the pioneer investor's risk, if prudent investment and reproduction cost were not distorted by changes in price levels or technology, each of them would produce the same result. The realization from the risk of an investment in a speculative field, such as natural gas utilities, should be reflected in the present fair value.[4] [illegible] amount of evidence to be admitted on any point was of course in the agency's reasonable discretion, and it was free to give its own weight to these or other factors and to determine from all the evidence its own judgment as to the necessary rates.

I agree with the Court in not imposing a rule of prudent investment alone in determining the rate base. This leaves the Commission free, as I understand it, to use any available evidence for its finding of fair value, including both prudent investment and the cost of installing at the present time an efficient system for furnishing the needed utility service.

My disagreement with the Court arises primarily from its view that it makes no difference how the Commission reached the rate fixed so long as the result is fair and reasonable. For me the statutory command to the Commission is more explicit. Entirely aside from the constitutional problem of whether the Congress could validly delegate its rate making power to the Commission, *in toto* and without standards, it did legislate in the light of the relation of fair and reasonable to fair value and reasonable return. The Commission must therefore make its findings in observance of that relationship.

The Federal Power Commission did not, as I construe their action, disregard its statutory duty. They heard the evidence relating to historical and reproduction cost and to the reasonable rate of return, and they appraised its weight. The evidence of reproduction cost was rejected as unpersuasive, but from the other evidence they found a rate base, which is to me a determination of fair value. On that base the earnings allowed seem fair and reasonable. So far as the Commission went in appraising the property employed in the service, I find nothing in the result

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[4] It is of no more than bookkeeping significance whether the Commission allows a rate of return commensurate with the risk of the original investment or the lower rate based on current risk and a capitalization reflecting the established earning power of a successful company and the probable cost of duplicating its services. *Cf.* A. T. & T. *v.* United States, 299 U. S. 232. But the latter is the traditional method.

which indicates confiscation, unfairness or unreasonableness. Good administration of rate making agencies under this method would avoid undue delay and render revaluations unnecessary except after violent fluctuations of price levels. Rate making under this method has been subjected to criticism. But until Congress changes the standards for the agencies, these rate making bodies should continue the conventional theory of rate making. It will probably be simpler to improve present methods than to devise new ones.

But a major error, I think, was committed in the disregard by the Commission of the investment in exploratory operations and other recognized capital costs. These were not considered by the Commission because they were charged to operating expenses by the company at a time when it was unregulated. Congress did not direct the Commission in rate making to deduct from the rate base capital investment which had been recovered during the unregulated period through excess earnings. In my view this part of the investment should no more have been disregarded in the rate base than any other capital investment which previously had been recovered and paid out in dividends or placed to surplus. Even if prudent investment throughout the life of the property is accepted as the formula for figuring the rate base, it seems to me illogical to throw out the admittedly prudent cost of part of the property because the earnings in the unregulated period had been sufficient to return the prudent cost to the investors over and above a reasonable return. What would the answer be under the theory of the Commission and the Court, if the only prudent investment in this utility had been the seventeen million capital charges which are now disallowed?

For the reasons heretofore stated, I should affirm the action of the Circuit Court of Appeals in returning the proceeding to the Commission for further consideration and should direct the Commission to accept the disallowed capital investment in determining the fair value for rate making purposes.

SUPREME COURT OF THE UNITED STATES.

Nos. 34 and 35.—OCTOBER TERM, 1943.

Federal Power Commission, City of Akron and Pennsylvania Public Utility Commission, Petitioners, 34 *vs.* Hope Natural Gas Company. City of Cleveland, Petitioner, 35 *vs.* Hope Natural Gas Company.	On Writs of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[January 3, 1944.]

Mr. Justice FRANKFURTER, dissenting.

My brother JACKSON has analyzed with particularity the economic and social aspects of natural gas as well as the difficulties which led to the enactment of the Natural Gas Act, especially those arising out of the abortive attempts of States to regulate natural gas utilities. The Natural Gas Act of 1938 should receive application in the light of this analysis, and Mr. Justice JACKSON has, I believe, drawn relevant inferences regarding the duty of the Federal Power Commission in fixing natural gas rates. His exposition seems to me unanswered, and I shall say only a few words to emphasize my basic agreement with him.

For our society the needs that are met by public utilities are as truly public services as the traditional governmental functions of police and justice. They are not less so when these services are rendered by private enterprise under governmental regulation. Who ultimately determines the ways of regulation, is the decisive aspect in the public supervision of privately-owned utilities. Foreshadowed nearly sixty years ago, *Railroad Commission Cases*, 116 U. S. 307, 331, it was decided more than fifty years ago that the final say under the Constitution lies with the judiciary and not the legislature. *Chicago etc. Railway Co.* v. *Minnesota*, 134 U. S. 418.

While legal issues touching the proper distribution of governmental powers under the Constitution may always be raised, Congressional acquiescence to date in the doctrine of *Chicago etc. Railway Co.* v. *Minnesota, supra*, may fairly be claimed. But in any event that issue is not here in controversy. As pointed out in the opinions of my brethren, Congress has given only limited authority to the Federal Power Commission and made the exercise of that authority subject to judicial review. The Commission is authorized to fix rates chargeable for natural gas. But the rates that it can fix must be "just and reasonable". § 5 of the Natural Gas Act, 15 U. S. C. § 717(d). Instead of making the Commission's rate determinations final, Congress specifically provided for court review of such orders. To be sure, "the finding of the Commission as to the facts, if supported by substantial evidence" was made "conclusive", § 19 of the Act, 15 U. S. C. § 717r. But obedience of the requirement of Congress that rates be "just and reasonable" is not an issue of fact of which the Commission's own determination is conclusive. Otherwise, there would be nothing for a court to review except questions of compliance with the procedural provisions of the Natural Gas Act. Congress might have seen fit so to cast its legislation. But it has not done so. It has committed to the administration of the Federal Power Commission the duty of applying standards of fair dealing and of reasonableness relevant to the purposes expressed by the Natural Gas Act. The requirement that rates must be "just and reasonable" means just and reasonable in relation to appropriate standards. Otherwise Congress would have directed the Commission to fix such rates as in the judgment of the Commission are just and reasonable; it would not have also provided that such determinations by the Commission are subject to court review.

To what sources then are the Commission and the courts to go for ascertaining the standards relevant to the regulation of natural gas rates? It is at this point that Mr. Justice JACKSON's analysis seems to me pertinent. There appear to be two alternatives. Either the fixing of natural gas rates must be left to the unguided discretion of the Commission so long as the rates it fixes do not reveal a glaringly bad prophecy of the ability of a regulated utility to continue its service in the future. Or the Commission's rate orders must be founded on due consideration of all

the elements of the public interest which the production and distribution of natural gas involve just because it is natural gas. These elements are reflected in the Natural Gas Act, if that Act be applied as an entirety. See, for instance, §§ 4(a)(b)(c)(d), 6, and 11, 15 U. S. C. § 717c (a)(b)(c)(d), 717e, and 717j. Of course the statute is not concerned with abstract theories of ratemaking. But its very foundation is the "public interest", and the public interest is a texture of multiple strands. It includes more than contemporary investors and contemporary consumers. The needs to be served are not restricted to immediacy, and social as well as economic costs must be counted.

It will not do to say that it must all be left to the skill of experts. Expertise is a rational process and a rational process implies ~~articulation of~~ expressed reasons for judgment. It will little advance the public interest to substitute for the hodge-podge of the rule in *Smyth* v. *Ames*, 169 U. S. 466, an encouragement of conscious obscurity or confusion in reaching a result, on the assumption that so long as the result appears harmless its basis is irrelevant. That may be an appropriate attitude when state action is challenged as unconstitutional. Cf. *Driscoll* v. *Edison Co.*, 307 U. S. 104. But it is not to be assumed that it was the design of Congress to make the accommodation of the conflicting interests exposed in Mr. Justice Jackson's opinion the occasion for a blind clash of forces or a partial assessment of relevant factors, either before the Commission or here.

The objection to the Commission's action is not that the rates it granted were too low but that the range of its vision was too narrow. And since the issues before the Commission involved no less than the total public interest, the proceedings before it should not be judged by narrow conceptions of common law pleading. And so I conclude that the case should be returned to the Commission. In order to enable this Court to discharge its duty of reviewing the Commission's order, the Commission should set forth with explicitness the criteria by which it is guided in determining that rates are "just and reasonable", and it should determine the public interest that is in its keeping in the perspective of the considerations set forth by Mr. Justice Jackson.

SUPREME COURT OF THE UNITED STATES.

Nos. 34, 35.—October Term, 1943.

Federal Power Commission, City of Akron and Pennsylvania Public Utility Commission, Petitioners, 34 *vs.* Hope Natural Gas Company. City of Cleveland, Petitioner, 35 *vs.* Hope Natural Gas Company.	On Writs of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[January 3, 1944.]

By Mr. Justice Jackson.

Certainly the theory of the court below that ties rate-making to the fair-value-reproduction-cost formula should be overruled as in conflict with *Federal Power Commission* v. *Natural Gas Pipeline Co.*[1] But the case should, I think, be the occasion for reconsideration of our rate-making doctrine as applied to natural gas and should be returned to the Commission for further consideration in the light thereof.

The Commission appears to have understood the effect of the two opinions in the *Pipeline* case to be at least authority and perhaps direction to fix natural gas rates by exclusive application of the "prudent investment" rate base theory. This has no warrant in the opinion of the Chief Justice for the Court, however, which released the Commission from subservience to "any single formula or combination of formulas" provided its order, "viewed in its entirety, produces no arbitrary result." 315 U. S. at 586. The minority opinion I understood to advocate the "prudent investment" theory as a sufficient guide in a natural gas case. The view was expressed in the court below that since this opinion was not expressly controverted it must have been approved.[2] I dis-

[1] 315 U. S. 575.

[2] Judge Dobie, dissenting below, pointed out that the majority opinion in the *Pipeline* case "contains no express discussion of the Prudent Investment Theory" and that the concurring opinion contained a clear one, and said, "It

claim this imputed approval with some particularity, because I attach importance at the very beginning of federal regulation of the natural gas industry to approaching it as the performance of economic functions, not as the performance of legalistic rituals.

I.

Solutions of these cases must consider eccentricities of the industry which gives rise to them and also to the Act of Congress by which they are governed.

The heart of this problem is the elusive, exhaustible, and irreplaceable nature of natural gas itself. Given sufficient money, we can produce any desired amount of railroad, bus, or steamship transportation, or communications facilities, or capacity for generation of electric energy, or for the manufacture of gas of a kind. In the service of such utilities one customer has little concern with the amount taken by another, one's waste will not deprive another, a volume of service can be created equal to demand, and today's demands will not exhaust or lessen capacity to serve tomorrow. But the wealth of Midas and the wit of man cannot produce or reproduce a natural gas field. We cannot even reproduce the gas, for our manufactured product has only about half the heating value per unit of nature's own.[3]

Natural gas in some quantity is produced in twenty-four states. It is consumed in only thirty-five states, and is available only to about 7,600,000 consumers.[4] Its availability has been more localized than that of any other utility service becauase it has depended more on the caprice of nature.

The supply of the Hope Company is drawn from that old and rich and vanishing field that flanks the Appalachian mountains. Its center of production is Pennsylvania and West Virginia, with a fringe of lesser production in New York, Ohio, Kentucky, Ten-

is difficult for me to believe that the majority of the Supreme Court, believing otherwise, would leave such a statement unchallenged.'' The fact that two other Justices had as matter of record in our books long opposed the reproduction cost theory of rate bases and had commented favorably on the prudent investment theory may have influenced that conclusion. See opinion of Mr. Justice Frankfurter in Driscoll *v.* Edison Light & Power Co., 307 U. S. 104, 122, and my brief as Solicitor General in that case. It should be noted, however, that these statements were made, not in a natural gas case, but in an electric power case—a very important distinction, as I shall try to make plain.

[3] Natural gas from the Appalachian field averages about 1050 to 1150 B.T.U. content, while by-product manufactured gas is about 530 to 540. Moody's Manual of Public Utilities (1943) 1350; Youngberg, Natural Gas (1930) 7.

[4] Sen. Rep. No. 1162, 75th Cong., 1st Sess., 2.

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nessee, and the north end of Alabama. Oil was discovered in commercial quantities at a depth of only 69½ feet near Titusville, Pennsylvania, in 1859. Its value then was about $16 per barrel.[5] The oil branch of the petroleum industry went forward at once, and with unprecedented speed. The area productive of oil and gas was roughed out by the drilling of over 19,000 "wildcat" wells, estimated to have cost over $222,000,000. Of these, over 18,000, or 94.9 per cent, were "dry holes." About five per cent, or 990 wells, made discoveries of commercial importance, 767 of them resulting chiefly in oil and [redacted] in gas only.[6] Prospecting for many years was a search for oil, and to strike gas was a misfortune. Waste during this period and even later is appalling. Gas was regarded as having no commercial value until about 1882, in which year the total yield was valued only at about $75,000.[7] Since then, contrary to oil, which has become cheaper, gas in this field has pretty steadily advanced in price. 223

While for many years natural gas had been distributed on a small scale for lighting,[8] its acceptance was slow, facilities for its utilization were primitive, and not until 1885 did it take on the appearance of a substantial industry.[9] Soon monopoly of production or markets developed.[10] To get gas from the mountain country, where it was largely found, to centers of population, where it was in demand, required very large investment. By ownership of such facilities a few corporate systems, each including several companies, controlled access to markets. Their purchases became the dominating factor in giving a market value to gas produced by many small operators. Hope is the market for over 300 such operators. By 1928 natural gas in the Appalachian field

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[5] Arnold and Kemnitzer, Petroleum in the United States and Possessions (1931) 78.

[6] *Id.* at 62-63.

[7] *Id.* at 61.

[8] At Fredonia, New York, in 1821, natural gas was conveyed from a shallow well to some thirty people. The lighthouse at Barcelona Harbor, near what is now Westfield, New York, was at about that time and for many years afterward lighted by gas that issued from a crevice. Report on Utility Corporations by Federal Trade Commission, Sen. Doc. 92, Pt. 84-A, 70th Cong., 1st Sess., 8-9.

[9] In that year Pennsylvania enacted "An Act to provide for the incorporation and regulation of natural gas companies." Penn. Laws 1885, No. 32.

[10] See Steptoe and Hoffheimer's Memorandum for Governor Cornwell of West Virginia (1917) 25 West Virginia Law Quarterly 257; see also Report on Utility Corporations by Federal Trade Commission, Sen. Doc. No. 92, Pt. 84-A, 70th Cong., 1st Sess.

commanded an average price of 21.1 cents per m.c.f. at points of production and was bringing 45.7 cents at points of consumption.[11] The companies which controlled markets, however, did not rely on gas purchases alone. They acquired and held in fee or leasehold great acreage in territory proved by "wildcat" drilling. These large marketing system companies as well as many small independent owners and operators have carried on the commercial development of proved territory. The development risks appear from the estimate that up to 1928, 312,318 proved area wells had been sunk in the Appalachian field of which 48,962, or 15.7 per cent, failed to produce oil or gas in commercial quantity.[12]

With the source of supply thus tapped to serve centers of large demand, like Pittsburgh, Buffalo, Cleveland, Youngstown, Akron, and other industrial communities, the distribution of natural gas fast became big business. Its advantages as a fuel and its price commended it, and the business yielded a handsome return. All was merry and the goose hung high for consumers and gas companies alike until about the time of the first World War. Almost unnoticed by the consuming public, the whole Appalachian field passed its peak of production and started to decline. Pennsylvania, which to 1928 had given off about 38 per cent of the natural gas from this field, had its peak in 1905; Ohio, which had produced 14 per cent, had its peak in 1915; and West Virginia, greatest producer of all, with 45 per cent to its credit, reached its peak in 1917.[13]

Western New York and Eastern Ohio, on the fringe of the field, had some production but relied heavily on imports from Pennsylvania and West Virginia. Pennsylvania, a producing and exporting state, was a heavy consumer and supplemented her production with imports from West Virginia. West Virginia was a consuming state, but the lion's share of her production was exported. Thus the interest of the states in the North Appalachian supply was in conflict.

Competition among localities to share in the failing supply and the helplessness of state and local authorities in the presence of state lines and corporate complexities is a part of the

11 Arnold and Kemnitzer, Petroleum in the United States and Possessions (1931) 73.

12 *Id.* at 63.

13 *Id.* at 64.

background of federal intervention in the industry.[14] West Virginia took the boldest measure. It legislated a priority in its entire production in favor of its own inhabitants. That was frustrated by an injunction from this Court.[15] Throughout the region clashes in the courts and conflicting decisions evidenced public anxiety and confusion. It was held that the New York Public Service Commission did not have power to classify consumers and restrict their use of gas.[16] That Commission held that a company could not abandon a part of its territory and still serve the rest.[17] Some courts admonished the companies to take action to protect consumers.[18] Several courts held that companies, regardless of failing supply, must continue to take on customers, but such compulsory additions were finally held to be within the Public Service Commission's discretion.[19] There were attempts to throw up franchises and quit the service, and municipalities resorted to the courts with conflicting results.[20] Public service commissions of consuming states were handicapped, for they had no control of the supply.[21]

Shortages during World War I occasioned the first intervention in the natural gas industry by the Federal Government. Under Proclamation of President Wilson the United States Fuel Admin-

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14 See Report on Utility Corporations by Federal Trade Commission, Sen. Doc. No. 92, Pt. 84-A, 70th Cong., 1st Sess.

15 Pennsylvania *v.* West Virginia, 262 U. S. 553. For conditions there which provoked this legislation, see 25 West Virginia Law Quarterly 257.

16 People *ex rel.* Pavilion Gas Co. *v.* Public Service Commission, 188 App. Div. 36, 176 N. Y. S. 163.

17 Village of Falconer *v.* Pennsylvania Gas Company, 17 State Department Reports (N. Y.) 407.

18 See, for example, Public Service Commission *v.* Iroquois Natural Gas Co., 108 Misc. 696, 178 N. Y. S. 24; Park Abbott Realty Co. *v.* Iroquois Gas Co., 102 Misc. 266, 168 N. Y. S. 673; Public Service Commission *v.* Iroquois Natural Gas Co., 189 App. Div. 545, 179 N. Y. S. 230.

19 People *ex rel.* Pennsylvania Gas Co. v. Public Service Commission, 196 App. Div. 514, 189 N. Y. S. 478.

20 East Ohio Gas Co. *v.* Akron, 81 Ohio St. 33, 90 N. E. 40; Newcomerstown *v.* Consolidated Gas Co., 100 Ohio St. 494, 127 N. E. 414; Grans *v.* Village of Ft. Laramie, 100 Ohio St. 35, 125 N. E. 112; Jamestown *v.* Pennsylvania Gas Co., 263 Fed. 437, 264 Fed. 1009. See also United Fuel Gas Co. *v.* Railroad Commission, 278 U. S. 300, 308.

21 The New York Public Service Commission said: "While the transportation of natural gas through pipe lines from one state to another state is interstate commerce . . . , Congress has not taken over the regulation of that particular industry. Indeed, it has expressly excepted it from the operation of the Interstate Commerce Commissions Law (Interstate Commerce Commissions Law, section 1). It is quite clear, therefore, that this Commission

istrator took control, stopped extensions, classified consumers and established a priority for domestic over industrial use.[22] After the war federal control was abandoned. Some cities once served with natural gas became dependent upon a mixed gas of reduced heating value and relatively higher price.[23]

Utilization of natural gas of highest social as well as economic return is domestic use for cooking and water heating, followed closely by use for space heating in homes. This is the true public utility aspect of the enterprise, and its preservation should be the first concern of regulation. Gas does the family cooking cheaper than any other fuel.[24] But its advantages do not end with dollars and cents cost. It is delivered without interruption at the meter as needed and is paid for after it is used. No money is tied up in a supply, and no space is used for storage. It requires no handling, creates no dust, and leaves no ash. It responds to thermostatic control. It ignites easily and immediately develops its maximum heating capacity. These incidental advantages make domestic life more liveable.

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can not require a Pennsylvania corporation, producing gas in Pennsylvania to transport it and deliver it in the State of New York, and that the Interstate Commerce Commission is likewise powerless. If there exists such a power, and it seems that there does, it is a power vested in Congress and by it not yet exercised. There is no available source of supply for the Crystal City Company at present except through purchasing from the Potter Gas Company. It is possible that this Commission might fix a price at which the Potter Gas Company should sell if it sold at all, but as the Commission can not require it to supply gas in the State of New York, the exercise of such a power to fix the price, if such power exists, would merely say, sell at this price or keep out of the State." Lane *v.* Crystal City Gas Co., 8 New York Public Service Comm. Reports, Second District, 210, 212.

22 Proclamation by the President of September 16, 1918; Rules and Regulations of H. A. Garfield, Fuel Administrator, September 24, 1918.

23 For example, the Iroquois Gas Corporation which formerly served Buffalo, New York, with natural gas ranging from 1050 to 1150 b.t.u. per cu. ft., now mixes a by-product gas of between 530 and 540 b.t.u. in proportions to provide a mixed gas of about 900 b.t.u. per cu. ft. For space heating or water heating its charges range from 65 cents for the first 10 m.c.f. per month to 55 cents for all above 25 m.c.f. per month. Moody's Manual of Public Utilities (1943) 1350.

24 The United States Fuel Administration made the following cooking value comparisons, based on tests made in the Department of Home Economics of Ohio State University:

Natural gas at 1.12 per M. is equivalent to coal at $6.50 per ton.
Natural gas at 2.00 per M. is equivalent to gasoline at 27¢ per gal.
Natural gas at 2.20 per M. is equivalent to electricity at 3¢ per k.w.h.
Natural gas at 2.40 per M. is equivalent to coal oil at 15¢ per gal.

Use and Conservation of Natural Gas, issued by U. S. Fuel Administration (1918) 5.

Industrial use is induced less by these qualities than by low cost in competition with other fuels. Of the gas exported from West Virginia by the Hope Company a very substantial part is used by industries. This wholesale use speeds exhaustion of supply and displaces other fuels. Coal miners and the coal industry, a large part of whose costs are wages, have complained of unfair competition from low-priced industrial gas produced with relatively little labor cost.[25]

Gas rate structures generally have favored industrial users. In 1932, in Ohio, the average yield on gas for domestic consumption was 62.1 cents per m.c.f. and on industrial, 38.7 In Pennsylvania, the figures were 62.9 against 31.7. West Virginia showed the least spread, domestic consumers paying 36.6 cents; and industrial, 27.7.[26] Although this spread is less than in other parts of the United States,[27] it can hardly be said to be self-justifying. It certainly is a very great factor in hastening decline of the natural gas supply.

About the time of World War I there were occasional and short-lived efforts by some hard-pressed companies to reverse this discrimination and adopt graduated rates, giving a low rate to quantities adequate for domestic use and graduating it upward to discourage industrial use.[28] These rates met opposition from industrial sources, of course, and since diminished revenues from industrial sources tended to increase the domestic price, they met little popular or commission favor. The fact is that neither the gas companies nor the consumers nor local regulatory bodies can be depended upon to conserve gas. Unless federal regulation will

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25 See Brief on Behalf of Legislation Imposing an Excise Tax on Natural Gas, submitted to N. R. A. by the United Mine Workers of America and the National Coal Association.

26 Brief of National Gas Association and United Mine Workers, *supra* note 26, pp. 35, 36, compiled from Bureau of Mines Reports.

27 From the source quoted in the preceding note the spread elsewhere is shown to be:

State	*Industrial*	*Domestic*
Illinois	29.2	1.678
Louisiana	10.4	59.7
Oklahoma	11.2	41.5
Texas	13.1	59.7
Alabama	17.8	1.227
Georgia	22.9	1.043

28 In Corning, New York, rates were initiated by the Crystal City Gas Company as follows: 70¢ for the first 5,000 cu. ft. per month; 80¢ from 5,000 to 12,000; $1.00 for all over 12,000. The Public Service Commission rejected

take account of conservation, its efforts seem, as in this case, actually to constitute a new threat to the life of the Appalachian supply.

II.

Congress in 1938 decided upon federal regulation of the industry. It did so after an exhaustive investigation of all aspects including failing supply and competition for the use of natural gas intensified by growing scarcity.[29] Pipelines from the Appalachian area to markets were in the control of a handful of holding company systems.[30] This created a highly concentrated control of the producers' market and of the consumers' supplies. While holding companies dominated both production and distribution they segregated those activities in separate subsidiaries,[31] the effect of which, if not the purpose, was to isolate some end of the business from the reach of any one state commission. The cost of natural

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these rates and fixed a flat rate of 58¢ per m.c.f. Lane v. Crystal City Gas Co., 8 New York Public Service Comm. Reports, Second District, 210.

The Pennsylvania Gas Company (National Fuel Gas Company group) also attempted a sliding scale rate for New York consumers, net per month as follows: First 5,000 feet, 35¢; second 5,000 feet, 45¢; third 5,000 feet, 50¢; all above 15,000, 55¢. This was eventually abandoned, however. The company's present scale in Pennsylvania appears to be reversed to the following net monthly rate: first 3 m.c.f., 75¢; next 4 m.c.f., 60¢; next 8 m.c.f., 55¢; over 15 m.c.f., 50¢. Moody's Manual of Public Utilities (1943) 1350. In New York it now serves a mixed gas.

For a study of effect of sliding scale rates in reducing consumption see 11 Proceedings of Natural Gas Association of America (1919) 287.

29 See Report on Utility Corporations by Federal Trade Commission, Sen. Doc. 92, Pt. 84-A, 70th Cong., 1st Sess.

30 Four holding company systems control over 55 per cent of all natural gas transmission lines in the United States. They are Columbia Gas and Electric Corporation, Cities Service Co., Electric Bond and Share Co., and Standard Oil Co. of New Jersey. Columbia alone controls nearly 25 per cent, and fifteen companies account for over 80 per cent of the total. Report on Utility Corporations by Federal Trade Commission, Sen Doc. 92, Pt. 84-A, 70th Cong., 1st Sess., 28.

In 1915, so it was reported to the Governor of West Virginia, 87 per cent of the total gas production of that state was under control of eight companies. Steptoe and Hoffheimer, Legislative Regulation of Natural Gas Supply in West Virginia, 17 West Virginia Law Quarterly 257, 260. Of these, three were subsidiaries of the Columbia system and others were subsidiaries of larger systems. In view of inter-system sales and interlocking interests it may be doubted whether there is much real competition among these companies.

31 This pattern with its effects on local regulatory efforts will be observed in our decisions. See United Fuel Gas Co. v. Railroad Commission, 278 U. S. 300; United Fuel Gas Co. v. Public Service Commission, 278 U. S. 322; Dayton Power & Light v. Public Utilities Commission, 292 U. S. 290; Columbus Gas & Fuel Co. v. Public Utilities Commission, 292 U. S. 398, and the present case.

gas to consumers moved steadily upwards over the years, out of proportion to prices of oil, which, except for the element of competition, is produced under somewhat comparable conditions. The public came to feel that the companies were exploiting the growing scarcity of local gas. The problems of this region had much to do with creating the demand for federal regulation.

The Natural Gas Act declared the natural gas business to be "affected with a *public interest,*" and its regulation "necessary in the *public interest.*"[32] Originally, and at the time this proceeding was commenced and tried, it also declared "the intention of Congress that natural gas shall be sold in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial or any other use at the lowest possible reasonable rate *consistent with the maintenance of adequate service in the public interest.*"[33] While this was later dropped, there is nothing to indicate that it was not and is not still an accurate statement of purpose of the Act. Extension or improvement of facilities may be ordered when "necessary or desirable in the public interest," abandonment of facilities may be ordered when the supply is "depleted to the extent that the continuance of service is unwarranted, or that the *present or future public convenience or necessity* permit" abandonment and certain extensions can only be made on finding of "the *present or future* convenience and necessity."[34] The Commission is required to take account of the ultimate use of the gas. Thus it is given power to suspend new schedules as to rates, charges, and classification of services except where the schedules are for the sale of gas "for resale for industrial use only,"[35] which gives the companies greater freedom to increase rates on industrial gas than on domestic gas. More particularly, the Act expressly forbids any undue preference or advantage to any person or "*any unreasonable difference in rates . . . either as between localities or as between classes of service.*"[36] And the power of the Commission expressly includes that to determine the "just and reasonable *rate, charge, classification, rule, regulation, practice or contract* to be thereafter observed and in force."[37]

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[32] 15 U. S. C. § 717(a). (Italics supplied throughout this paragraph.)
[33] § 7(c), 52 Stat. 825.
[34] 15 U. S. C. § 717f.
[35] *Id.*, § 717c(e).
[36] *Id.*, § 717c(b).
[37] *Id.*, § 717d(a).

In view of the Court's opinion that the Commission in administering the Act may ignore discrimination, it is interesting that in reporting this Bill both the Senate and the House Committees on Interstate Commerce pointed out that in 1934, on a nation-wide average the price of natural gas per m.c.f. was 74.6 cents for domestic use, 49.6 cents for commercial use, and 16.9 for industrial use.[38] I am not ready to think that supporters of a bill called attention to the striking fact that householders were being charged five times as much for their gas as industrial users only as a situation which the Bill would do nothing to remedy. On the other hand the Act gave to the Commission what the Court aptly describes as "broad powers of regulation."

III.

This proceeding was initiated by the Cities of Cleveland and Akron. They alleged that the price charged by Hope for natural gas "for resale to domestic, commercial and small industrial consumers in Cleveland and elsewhere is excessive, unjust, unreasonable, greatly in excess of the price charged by Hope to nonaffiliated companies at wholesale for resale to domestic, commercial and small industrial consumers, and *greatly in excess of the price charged by Hope to East Ohio for resale to certain favored industrial consumers in Ohio, and therefore is further unduly discriminatory between consumers and between classes of service*" [italics supplied]. The company answered admitting differences in prices to affiliated and nonaffiliated companies and justifying them by differences in conditions of delivery. As to the allegation that the contract price is "greatly in excess of the price charged by Hope to East Ohio for resale to certain favored industrial consumers in Ohio," Hope did not deny a price differential, but alleged that industrial gas was not sold to "favored consumers" but was sold under contracts and schedules filed with and approved by the Public Utilities Commission of Ohio, and that certain conditions of delivery made it not "unduly discriminatory."

The record shows that in 1940 Hope delivered for industrial consumption 36,523,792 m.c.f. and for domestic and commercial consumption, 50,343,652 m.c.f. I find no separate figure for domestic consumption. It served 43,767 domestic consumers directly, 511,521 through the East Ohio Gas Company, and 154,043

38 Sen. Rep. No. 1162, 75th Cong., 1st Sess. 2.

through the Peoples Natural Gas Company, both affiliates owned by the same parent. Its special contracts for industrial consumption, so far as appear, are confined to about a dozen big industries.

Hope is responsible for such discrimination as exists in favor of these few industrial consumers. It controls both the resale price and use of industrial gas by virtue of the very interstate sales contracts over which the Commission is exercising its jurisdiction.

Hope's contract with East Ohio Company is an example. Hope agrees to deliver, and the Ohio Company to take, "(a) all natural gas requisite for the supply of the domestic consumers of the Ohio Company; (b) such amounts of natural gas as may be requisite to fulfill contracts made with the consent and approval of the Hope Company by the Ohio Company, or companies which it supplies with natural gas, for the sale of gas upon special terms and conditions for manufacturing purposes." The Ohio company is required to read domestic customers' meters once a month and meters of industrial customers daily and to furnish all meter readings to Hope. The Hope Company is to have access to meters of all consumers and to all of the Ohio Company's accounts. The domestic consumers of the Ohio Company are to be fully supplied in preference to consumers purchasing for manufacturing purposes and "Hope Company can be required to supply gas to be used for manufacturing purposes only where the same is sold under special contracts which have first been submitted to and approved in writing by the Hope Company and which expressly provide that natural gas will be supplied thereunder only in so far as the same is not necessary to meet the requirements of domestic consumers supplied through pipe lines of the Ohio Company." This basic contract was supplemented from time to time, chiefly as to price. The last amendment was in a letter from Hope to East Ohio in 1937. It contained a special discount on industrial gas and a schedule of special industrial contracts. Hope reserving the right to make eliminations therefrom and agreeing that others might be added from time to time with its approval in writing. It said, "It is believed that the price concessions contained in this letter, *while not based on our costs*, are, under certain conditions, to our mutual advantage in main-

taining and building up the volumes of gas sold by us [italics supplied]."[39]

The Commission took no note of the charges of discrimination and made no disposition of the issue tendered on this point. It ordered a flat reduction in the price per m.c.f. of all gas delivered by Hope in interstate commerce. It made no limitation, condition, or provision as to what classes of consumers should get the benefit of the reduction. While the cities have accepted and are defending the reduction, it is my view that the discrimination of which they have complained is perpetuated and increased by the order of the Commission and that it violates the Act in so doing.

The Commission's opinion aptly characterizes its entire objective by saying that "bona fide investment figures now become all-important in the regulation of rates." It should be noted that the all-importance of this theory is not the result of any instruction from Congress. When the Bill to regulate gas was first before Congress it contained the following: "In determining just and reasonable rates the Commission shall fix such rate as will allow a fair return upon the actual legitimate prudent cost of the property used and useful for the service in question." H. R. 5423, 74th Cong., 1st Sess. Title III, § 312(c). Congress rejected this language. See H. R. 5423, § 213[211(c)], and H. R. Rep. No. 1318, 74th Cong., 1st Sess. 30.

The Commission contends nevertheless that the "all important" formula for finding a rate base is that of prudent investment. But it excluded from the investment base an amount actually and admittedly invested of some $17,000,000. It did so be-

[39] The list of East Ohio Gas Company's special industrial contracts thus expressly under Hope's control and their demands are as follows:

Customer	*Ordinary Daily Requirements.*
Republic Steel Corporation	15,000,000 cu. ft.
Otis Steel Company	10,000,000
Timken Roller Bearing Co.	7,500,000
Youngstown Sheet & Tube Co.	7,000,000
U. S. Steel Corp.—Subsidiaries	6,500,000
General Electric Company	2,500,000
Pittsburgh Plate Glass Co.	2,000,000
Niles Rolling Mill Company	1,500,000
Chase Brass & Copper Company	700,000
U. S. Aluminum Company	400,000
Mahoning Valley Steel Company	400,000
Babcock & Wilcox Company	400,000
Canton Stamping & Enameling Co.	350,000

cause it says that the Company recouped these expenditures from customers before the days of regulation from earnings above a fair return. But it would not apply all of such "excess earnings" to reduce the rate base as one of the Commissioners suggested. The reason for applying excess earnings to reduce the investment base roughly from $69,000,000 to $52,000,000 but refusing to apply them to reduce it from that to some $18,000,000 is not found in a difference in the character of the earnings or in their reinvestment. The reason assigned is a difference in bookkeeping treatment many years before the Company was subject to regulation. The $17,000,000, reinvested chiefly in well drilling, was theated on the books as expense. (The Commission now requires that drilling costs be carried to capital account.) The allowed rate base thus actually was determined by the Company's bookkeeping, not its investment. This attributes a significance to formal classification in account keeping that seems inconsistent with rational rate regulation.[40] Of course, the Commission would not and should not allow a rate base to be inflated by bookkeeping which had improperly capitalized expenses. I have doubts about resting public regulation upon any rule that is to be used or not depending on which side it favors.

The Company on the other hand, has not put its gas fields into its calculations on the present-value basis, although that, it contends, is the only lawful rule for finding a rate base. To do so would result in a rate higher than it has charged or proposes as a matter of good business to charge.

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[40] To make a fetish of mere accounting is to shield from examination the deeper causes, forces, movements, and conditions which should govern rates. Even as a recording of current transactions, bookkeeping is hardly an exact science. As a representation of the condition and trend of a business, it uses symbols of certainty to express values that actually are in constant flux. It may be said that in commercial or investment banking or any business extending credit success depends on knowing what not to believe in accounting. Few concerns go into bankruptcy or reorganization whose books do not show them solvent and often even profitable. If one cannot rely on accountancy accurately to disclose past or current conditions of a business, the fallacy of using it as a sole guide to future price policy ought to be apparent. However, our quest for certitude is so ardent that we pay an irrational reverence to a technique which uses symbols of certainty, even though experience again and again warns us that they are delusive. Few writers have ventured to challenge this American idolatry, but see Hamilton, Cost as a Standard for Price, 4 Law and Contemporary Problems 321, 323-25. He observes that "As the apostle would put it, accountancy is all things to all men, . . . Its purpose determines the character of a system of accounts." He analyzes the hypothetical character of accounting and says "It was no eternal mold for pecuniary verities handed down from on high. It was—like logic or al-

The case before us demonstrates the lack of rational relationship between conventional rate-base formulas and natural gas production and the extremities to which regulating bodies are brought by the effort to rationalize them. The Commission and the Company each stands on a different theory, and neither ventures to carry its theory to logical conclusion as applied to gas fields.

IV.

This order is under judicial review not because we interpose constitutional theories between a State and the business it seeks to regulate, but because Congress put upon the federal courts a duty toward administration of a new federal regulatory Act. If we are to hold that a given rate is reasonable just because the Commission has said it was reasonable, review becomes a costly, time-consuming pageant of no practical value to anyone. If on the other hand we are to bring judgment of our own to the task, we should for the guidance of the regulators and the regulated reveal something of the philosophy, be it legal or economic or social, which guides us. We need not be slaves to a formula but unless we can point out a rational way of reaching our conclusions they can only be accepted as resting on intuition or predilection. I must admit that I possess no instinct by which to know the "reasonable" from the "unreasonable" in prices and must seek some conscious design for decision.

The Court sustains this order as reasonable, but what makes it so or what could possibly make it otherwise, I cannot learn. It holds that: "it is the result reached not the method employed which is controlling"; "the fact that the method employed to reach that result may contain infirmities is not then important" and it

gebra, or the device of analogy in the law—an ingenious contrivance of the human mind to serve a limited and practical purpose." "Accountancy is far from being a pecuniary expression of all that is industrial reality. It is an instrument, highly selective in its application, in the service of the institution of money making." As to capital account he observes "In an enterprise in lusty competition with others of its kind, survival is the thing and the system of accounts has its focus in solvency. . . . Accordingly depreciation, obsolescence, and other factors which carry no immediate threat are matters of lesser concern and the capital account is likely to be regarded as a secondary phenomenon. . . . But in an enterprise, such as a public utility, where continued survival seems assured, solvency is likely to be taken for granted. . . . A persistent and ingenious attention is likely to be directed not so much to securing the upkeep of the physical property as to making it certain that capitalization fails in not one whit to give full recognition to every item that should go into the account."

is not "important to this case to determine the various permissible ways in which any rate base on which the return is computed might be arrived at." The Court does lean somewhat on considerations of capitalization and dividend history and requirements for dividends on outstanding stock. But I can give no real weight to that for it is generally and I think deservedly in discredit as any guide in rate cases.[41]

Our books already contain so much talk of methods of rationalizing rates that we must appear ambiguous if we announce results without our working methods. We are confronted with regulation of a unique type of enterprise which I think requires considered rejection of much conventional utility doctrine and adoption of concepts of "just and reasonable" rates and practices and of the "public interest" that will take account of the peculiarities of the business.

The Court rejects the suggestions of this opinion. It says that the Committees in reporting the bill which became the Act said it provided "for regulation along recognized and more or less standardized lines" and that there was "nothing novel in its provisions." So saying it sustains a rate calculated on a novel variation of a rate base theory which itself had at the time of enactment of the legislation been recognized only in dissenting opinions. Our difference seems to be between unconscious innovation,[42] and the purposeful and deliberate innovation I would make to meet the necessities of regulating the industry before us.

Hope's business has two components of quite divergent character. One, while not a conventional common-carrier undertaking, is essentially a transportation enterprise consisting of conveying gas from where it is produced to point of delivery to the buyer. This is a relatively routine operation not differing substantially from many other utility operations. The service is produced by an investment in compression and transmission facilities. Its risks are those of investing in a tested means of conveying a discovered supply of gas to a known market. A rate

41 See 2 Bonbright, Valuation of Property (1937) 1112.

42 Bonbright says, " . . . the vice of traditional law lies, not in its adoption of excessively rigid concepts of value and rules of valuation, but rather in its tendency to permit shifts in meaning that are inept, or else that are ill-defined because the judges that make them will not openly admit that they are doing so." *Id.*, 1170.

base calculated on the prudent investment formula would seem a reasonably satisfactory measure for fixing a return from that branch of the business whose service is roughly proportionate to the capital invested. But it has other consequences which must not be overlooked. It gives marketability and hence "value" to gas owned by the company and gives the pipeline company a large power over the marketability and hence "value" of the production of others.

The other part of the business—to reduce to possession an adequate supply of natural gas—is of opposite character, being more erratic and irregular and unpredictable in relation to investment than any phase of any other utility business. A thousand feet of gas captured and severed from real estate for delivery to consumers is recognized under our law as property of much the same nature as a ton of coal, a barrel of oil, or a yard of sand. The value to be allowed for it is the real battleground between the investor and consumer. It is from this part of the business that the chief difference between the parties as to a proper rate base arises.

Is it necessary to a "reasonable" price for gas that it be anchored to a rate base of any kind? Why did courts in the first place begin valuing "rate bases" in order to "value" something else? The method came into vogue in fixing rates for transportation service which the public obtained from common carriers. The public received none of the carriers' physical property but did make some use of it. The carriage was often a monopoly so there were no open market criteria as to reasonableness. The "value" or "cost" of what was put to use in the service by the carrier was not a remote or irrelevant consideration in making such rates. Moreover the difficulty of appraising an intangible service was thought to be simplified if it could be related to physical property which was visible and measurable and the items of which might have market value. The court hoped to reason from the known to the unknown. But gas fields turn this method topsy turvy. Gas itself is tangible, possessible, and does have a market and a price in the field. The value of the rate base is more elusive than that of gas. It consists of intangibles—leaseholds and freeholds—operated and unoperated—of little use in themselves except as rights to reach and capture gas. Their value lies almost wholly in predictions of discovery, and of price of gas when captured.

and bears little relation to cost of tools and supplies and labor to develop it. Gas is what Hope sells and it can be directly priced more reasonably and easily and accurately than the components of a rate base can be valued. Hence the reason for resort to a roundabout way of rate base price fixing does not exist in the case of gas in the field.

But if found, and by whatever method found, a rate base is little help in determining reasonableness of the price of gas. Appraisal of present value of these intangible rights to pursue fugitive gas depends on the value assigned to the gas when captured. The "present fair value" rate base, generally in ill repute,[43] is not even urged by the gas company for valuing its fields.

The prudent investment theory has relative merits in fixing rates for a utility which creates its service merely by its investment. The amount and quality of service rendered by the usual utility will, at least roughly, be measured by the amount of capital it puts into the enterprise. But it has no rational application where there is no such relationship between investment and capacity to serve. There is no such relationship between investment and amount of gas produced. Let us assume that Doe and Roe each produces in West Virginia for delivery to Cleveland the same quantity of natural gas per day. Doe, however, through luck or foresight or whatever it takes, gets his gas from investing $50,000 in leases and drilling. Roe drilled poorer territory, got smaller wells, and has invested $250,000. Does anybody imagine that Roe can get or ought to get for his gas five times as much as Doe because he has spent five times as much? The service one renders to society in the gas business is measured by what he gets out of the ground, not by what he puts into it, and there is little more relation between the investment and the results than in a game of poker.

Two-thirds of the gas Hope handles it buys from about 340 independent producers. It is obvious that the principle of rate-making applied to Hope's own gas cannot be applied, and has not been applied, to the bulk of the gas Hope delivers. It is not probable that the investment of any two of these producers will bear the same ratio to their investments. The gas, however, all

43 "The attempt to regulate rates by reference to a periodic or occasional reappraisal of the properties has now been tested long enough to confirm the worst fears of its critics. Unless its place is taken by some more promising scheme of rate control, the days of private ownership under government regulation may be numbered." 2 Bonbright, Valuation of Property (1937) 1190.

goes to the same use, has the same utilization value and the same ultimate price.

To regulate such an enterprise by undiscriminatingly transplanting any body of rate doctrine conceived and adapted to the ordinary utility business can serve the "public interest" as the Natural Gas Act requires, if at all, only by accident. Mr. Justice Brandeis, the pioneer juristic advocate of the prudent investment theory for man-made utilities, never, so far as I am able to discover, proposed its application to a natural gas case. On the other hand, dissenting in *Pennsylvania* v. *West Virginia*, he reviewed the problems of gas supply and said, "In no other field of public service regulation is the controlling body confronted with factors so baffling as in the natural gas industry; and in none is continuous supervision and control required in so high a degree." 262 U. S. 553, 621. If natural gas rates are intelligently to be regulated we must fit our legal principles to the economy of the industry and not try to fit the industry to our books.

As our decisions stand the Commission was justified in believing that it was required to proceed by the rate base method even as to gas in the field. For this reason the Court may not merely wash its hands of the method and rationale of rate making. The fact is that this Court, with no discussion of its fitness, simply transferred the rate base method to the natural gas industry. It happened in *Newark Natural Gas & Fuel Co.* v. *City of Newark, Ohio*, 242 U. S. 405 (1917), in which the company wanted 25 cents per m.c.f., and under the Fourteenth Amendment challenged the reduction to 18 cents by ordinance. This Court sustained the reduction because the court below "gave careful consideration to the questions of the value of the property at the time of the inquiry," and whether the rate "would be sufficient to provide a fair return on the value of the property." The Court said this method was "based upon principles thoroughly established by repeated decisions of this court," citing many cases, not one of which involved natural gas or a comparable wasting natural resource. Then came issues as to state power to regulate as affected by the commerce clause. *Public Utilities Commission* v. *Landon*, 249 U. S. 236 (1919); *Pennsylvania Gas Co.* v. *Public Service Commission*, 252 U. S. 23 (1920). These questions settled, the Court again was called upon in natural gas cases to consider state rate-making claimed to be invalid under the Fourteenth Amendment.

United Fuel Gas Co. v. *Railroad Commission of Kentucky*, 278 U. S. 300 (1929); *United Fuel Gas Company* v. *Public Service Commission of West Virginia*, 278 U. S. 322 (1929). Then, as now, the differences were "due chiefly to the difference in value ascribed by each to the gas rights and leaseholds." 278 U. S. 300, 311. No one seems to have questioned that the rate base method must be pursued and the controversy was as to what rate base must be used. Later the "value" of gas in the field was questioned in determining the amount a regulated company should be allowed to pay an affiliate therefor—a state determination also reviewed under the Fourteenth Amendment. *Dayton Power & Light Company* v. *Public Utilities Commission of Ohio*, 292 U. S. 290 (1934); *Columbus Gas & Fuel Co.* v. *Public Utilities Commission of Ohio*, 292 U. S. 398 (1934). In both cases, one of which sustained, and one of which struck down a fixed rate the Court assumed the rate base method, as the legal way of testing reasonableness of natural gas prices fixed by public authority, without examining its real relevancy to the inquiry.

Under the weight of such precedents we cannot expect the Commission to initiate economically intelligent methods of fixing gas prices. But the Court now faces a new plan of federal regulation based on the power to fix the price at which gas shall be allowed to move in interstate commerce. I should now consider whether these rules devised under the Fourteenth Amendment are the exclusive tests of a just and reasonable rate under the federal statute, inviting reargument directed to that point if necessary. As I see it now I would be prepared to hold that these rules do not apply to a natural gas case arising under the Natural Gas Act.

Such a holding would leave the Commission to fix the price of gas in the field as one would fix maximum prices of oil or milk or coal, or any other commodity. Such a price is not calculated to produce a fair return on the synthetic value of a rate base of any individual producer, and would not undertake to assure a fair return to any producer. The emphasis would shift from the producer to the product, which would be regulated with an eye to average or typical producing conditions in the field.

Such a price fixing process on economic lines would offer little temptation to the judiciary to become back seat drivers of the price fixing machine. The unfortunate effect of judicial intervention in this field is to divert the attention of those engaged in the process

from what is economically wise to what is legally permissible. It is probable that price reductions would reach economically unwise and self-defeating limits before they would reach constitutional ones. Any constitutional problems growing out of price fixing are quite different than those that have heretofore been considered to inhere in rate making. A producer would have difficulty showing the invalidity of such a fixed price so long as he voluntarily continued to sell his product in interstate commerce. Should he withdraw and other authority be invoked to compel him to part with his property, a different problem would be presented.

Allowance in a rate to compensate for gas removed from gas lands, whether fixed as of point of production or as of point of delivery, probably best can be measured by a functional test applied to the whole industry. For good or ill we depend upon private enterprise to exploit these natural resources for public consumption. The function which an allowance for gas in the field should perform for society in such circumstances is to be enough and no more than enough to induce private enterprise completely and efficiently to utilize gas resources, to acquire for public service any available gas or gas rights and to deliver gas at a rate and for uses which will be in the future as well as in the present public interest.

The Court fears that "if we are now to tell the Commission to fix the rates so as to discourage particular uses, we would indeed be injecting into a rate case a 'novel' doctrine . . . ." With due deference I suggest that there is nothing novel in the idea that any change in price of a service or commodity reacts to encourage or discourage its use. The question is not whether such consequences will or will not follow; the question is whether effects must be suffered blindly or may be intelligently selected, whether price control shall have targets at which it deliberately aims or shall be handled like a gun in the hands of one who does not know it is loaded.

We should recognize "price" for what it is—a tool, a means, an expedient. In public hands it has much the same economic effects as in private hands. Hope knew that a concession in industrial price would tend to build up its volume of sales. It used price as an expedient to that end. The Commission makes another cut in that same price but the Court thinks we should ignore the effect that it will have on exhaustion of supply. The fact

is that in natural gas regulation price must be used to reconcile the private property right society has permitted to vest in an important natural resource with the claims of society upon it—price must draw a balance between wealth and welfare.

To carry this into techniques of inquiry is the task of the Commissioner rather than of the judge, and it certainly is no task to be solved by mere bookkeeping but requires the best economic talent available. There would doubtless be inquiry into the price gas is bringing in the field, how far that price is established by arms' length bargaining and how far it may be influenced by agreements in restraint of trade or monopolistic influences. What must Hope really pay to get and to replace gas it delivers under this order? If it should get more or less than that for its own, how much and why? How far are such prices influenced by pipe line access to markets and if the consumers pay returns on the pipe lines how far should the increment they cause go to gas producers? East Ohio is itself a producer in Ohio.[44] What do Ohio authorities require Ohio consumers to pay for gas in the field? Perhaps these are reasons why the Federal Government should put West Virginia gas at lower or at higher rates. If so what are they? Should East Ohio be required to exploit its half million acres of unoperated reserve in Ohio before West Virginia resources shall be supplied on a devalued basis of which that State complains and for which she threatens measures of self keep? What is gas worth in terms of other fuels it displaces?

A price cannot be fixed without considering its effect on the production of gas. Is it an incentive to continue to exploit vast unoperated reserves? Is it conducive to deep drilling tests the result of which we may know only after trial? Will it induce bringing gas from afar to supplement or even to substitute for Appalachian gas?[45] Can it be had from distant fields as cheap or cheaper? If so, that competitive potentiality is certainly a relevant consideration. Wise regulation must also consider, as a private buyer would, what alternatives the producer has if the

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44 East Ohio itself owns natural gas rights in 550,600 acres, 518,526 of which are reserved and 32,074 operated, by 375 wells. Moody's Manual of Public Utilities (1943) 5.

45 Hope has asked a certificate of convenience and necessity to lay 1140 miles of 22-inch pipeline from Hugoton gas fields in southwest Kansas to West Virginia to carry 285 million cu. ft. of natural gas per day. The cost was estimated at $51,000,000. Moody's Manual of Public Utilities (1943) 1760.

price is not acceptable. Hope has intrastate business and domestic and industrial customers. What can it do by way of diverting its supply to intrastate sales? What can it do by way of disposing of its operated or reserve acreage to industrial concerns or other buyers? What can West Virginia do by way of conservation laws, severance or other taxation, if the regulated rate offends? It must be borne in mind that while West Virginia was prohibited from giving her own inhabitants a priority that discriminated against interstate commerce, we have never yet held that a good faith conservation act, applicable to her own, as well as to others, is not valid. In considering alternatives, it must be noted that federal regulation is very incomplete, expressly excluding regulation of "production or gathering of natural gas," and that the only present way to get the gas seems to be to call it forth by price inducements. It is plain that there is a downward economic limit on a safe and wise price.

But there is nothing in the law which compels a commission to fix a price at that "value" which a company might give to its product by taking advantage of scarcity, or monopoly of supply. The very purpose of fixing maximum prices is to take away from the seller his opportunity to get all that otherwise the market would award him for his goods. This is a constitutional use of the power to fix maximum prices, *Block* v. *Hirsh*, 256 U. S. 135; *Marcus Brown Holding Co.* v. *Feldman*, 256 U. S. 170; *International Harvester Co.* v. *Kentucky*, 234 U. S. 216; *Highland* v. *Russell Car & Snow Plow Co.*, 279 U. S. 253, just as the fixing of minimum prices of goods in interstate commerce is constitutional although it takes away from the buyer the advantage in bargaining which market conditions would give him. *United States* v. *Darby*, 312 U. S. 100; *Mulford* v. *Smith*, 307 U. S. 38; *United States* v. *Rock Royal Co-operative, Inc.*, 307 U. S. 533; *Sunshine Anthracite Coal Co.* v. *Adkins*, 310 U. S. 381. The Commission has power to fix a price that will be both maximum and minimum and it has the incidental right, and I think the duty, to choose the economic consequences it will promote or retard in production and also more importantly in consumption, to which I now turn.

If we assume that the reduction in company revenues is warranted we then come to the question of translating the allowed return into rates for consumers or classes of consumers. Here the Commission fixed a single rate for all gas delivered irrespective of

its use despite the fact that Hope has established what amounts to two rates—a high one for domestic use and a lower one for industrial contracts.[46] The Commission can fix two prices for interstate gas as readily as one—a price for resale to domestic users and another for resale to industrial users. This is the pattern Hope itself has established in the very contracts over which the Commission is expressly given jurisdiction. Certainly the Act is broad enough to permit two prices to be fixed instead of one, if the concept of the "public interest" is not unduly narrowed.

The Commission's concept of the public interest in natural gas cases which is carried today into the Court's opinion was first announced in the opinion of the minority in the *Pipeline* case. It enumerated only two "phases of the public interest: (1) the investor interest; (2) the consumer interest," which it emphasized to the exclusion of all others. 315 U. S. 575, 606. This will do well enough in dealing with railroads or utilities supplying manufactured gas, electric power, a communications service or transportation, where utilization of facilities does not impair their future usefulness. Limitation of supply, however, brings into a natural gas case another phase of the public interest that to my mind overrides both the owner and the consumer of that interest. Both producers and industrial consumers have served their immediate private interests at the expense of the long-range public interest. The public interest, of course, requires stopping unjust enrichment of the owner. But it also requires stopping unjust impoverishment of future generations. The public interest in the use by Hope's half million domestic consumers is quite a different one from the public interest in use by a baker's dozen of industries.

Prudent price fixing it seems to me must at the very threshold determine whether any part of an allowed return shall be permitted to be realized from sales of gas for resale for industrial use. Such use does tend to level out daily and seasonal peaks of domestic demand and to some extent permits a lower charge for domestic service. But is that a wise way of making gas cheaper when, in comparison with any substitute, gas is already a cheap fuel? The interstate sales contracts provide that at times when demand is so great that there is not enough gas to go around domestic users shall first be served. Should the operation of

[46] I find little information as to the rates for industries in the record and none at all in such usual sources as Moody's Manual.

this preference await the day of actual shortage? Since the propriety of a preference seems conceded, should it not operate to prevent the coming of a shortage as well as to mitigate its effects? Should industrial use jeopardize tomorrow's service to householders any more than today's? If, however, it is decided to cheapen domestic use by resort to industrial sales, should they be limited to the few uses for which gas has special values or extend also to those who use it only because it is cheaper than competitive fuels?[47] And how much cheaper should industrial gas sell than domestic gas, and how much advantage should it have over competitive fuels? If industrial gas is to contribute at all to lowering domestic rates, should it not be made to contribute the very maximum of which it is capable, that is, should not its price be the highest at which the desired volume of sales can be realized?

If I were to answer I should say that the household rate should be the lowest that can be fixed under commercial conditions that will conserve the supply for that use. The lowest probable rate for that purpose is not likely to speed exhaustion much, for it still will be high enough to induce economy, and use for that purpose has more nearly reached the saturation point. On the other hand the demand for industrial gas at present rates already appears to be increasing. To lower further the industrial rate is merely

[47] The Federal Power Commission has touched upon the problem of conservation in connection with an application for a certificate permitting construction of a 1500-mile pipeline from southern Texas to New York City and says: "The Natural Gas Act as presently drafted does not enable the Commission to treat fully the serious implications of such a problem. The question should be raised as to whether the proposed use of natural gas would not result in displacing a less valuable fuel and create hardships in the industry already supplying the market, while at the same time rapidly depleting the country's natural-gas reserves. Although, for a period of perhaps 20 years, the natural gas could be so priced as to appear to offer an apparent saving in fuel costs, this would mean simply that social costs which must eventually be paid had been ignored.

"Careful study of the entire problem may lead to the conclusion that use of natural gas should be restricted by functions rather than by areas. Thus, it is especially adapted to space and water heating in urban homes and other buildings and to the various industrial heat processes which require concentration of heat, flexibility of control, and uniformity of results. Industrial uses to which it appears particularly adapted include the treating and annealing of metals, the operation of kilns in the ceramic, cement, and lime industries, the manufacture of glass in its various forms, and use as a raw material in the chemical industry. General use of natural gas under boilers for the production of steam is, however, under most circumstances of very questionable social economy." Twentieth Annual Report of the Federal Power Commission (1940) 79.

further to subsidize industrial consumption and speed depletion. The impact of the flat reduction of rates ordered here admittedly will be to increase the industrial advantages of gas over competing fuels and to increase its use. I think this is not, and there is no finding by the Commission that it is, in the public interest.

There is no justification in this record for the present discrimination against domestic users of gas in favor of industrial users. It is one of the evils against which the Natural Gas Act was aimed by Congress and one of the evils complained of here by Cleveland and Akron. If Hope's revenues should be cut by some $3,600,000 the whole reduction is owing to domestic users. If it be considered wise to raise part of Hope's revenues by industrial purpose sales, the utmost possible revenue should be raised from the least consumption of gas. If competitive relationships to other fuels will permit, the industrial price should be substantially advanced, not for the benefit of the Company, but the increased revenues from the advance should be applied to reduce domestic rates. For in my opinion the "public interest" requires that the great volume of gas now being put to uneconomic industrial use should either be saved for its more important future domestic use or the present domestic user should have the full benefit of its exchange value in reducing his present rates.

Of course the Commission's power directly to regulate does not extend to the fixing of rates at which the local company shall sell to consumers. Nor is such power required to accomplish the purpose. As already pointed out, the very contract the Commission is altering classifies the gas according to the purposes for which it is to be resold and provides differentials between the two classifications. It would only be necessary for the Commission to order that all gas supplied under paragraph (a) of Hope's contract with the East Ohio Company shall be at a stated price fixed to give to domestic service the entire reduction herein and any further reductions that may prove possible by increasing industrial rates. It might further provide that gas delivered under paragraph (b) of the contract for industrial purposes to those industrial customers Hope has approved in writing shall be at such other figure as might be found consistent with the public interest as herein defined. It is too late in the day to contend that the authority of a regulatory commission does not extend to a consideration of public interests which it may not

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directly regulate and a conditioning of its orders for their protection. *Interstate Commerce Commission* v. ~~*Railway Express*~~, 315 U. S. 373; *United States* v. *Lowden*, 308 U. S. 225.

Whether the Commission will assert its apparently broad statutory authorization over prices and discriminations is, of course, its own affair, not ours. It is entitled to its own notion of the "public interest" and its judgment of policy must prevail. However, where there is ground for thinking that views of this Court may have constrained the Commission to accept the rate-base method of decision and a particular single formula as "all important" for a rate base, it is appropriate to make clear the reasons why I, at least, would not be so understood. The Commission is free to face up realistically to the nature and peculiarity of the resources in its control, to foster their duration in fixing price, and to consider future interests in addition to those of investors and present consumers. If we return this case it may accept or decline the proffered freedom. This problem presents the Commission an unprecedented opportunity if it will boldly make sound economic considerations, instead of legal and accounting theories, the foundation of federal policy. I would return the case to the Commission and thereby be clearly quit of what now may appear to be some responsibility for perpetrating a shortsighted pattern of natural gas regulation.